

# **FINANCE – ACCOUNTING BANKING**

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# **THE COSTS' FINANCIAL ADMINISTRATION ON ELEMENTS OF EXPENSES BETWEEN NECESITY AND POSSIBILITY**

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Abstract:

*The goal of activity displayed by lucrative units is to obtain profit, seeking permanently its maximization. The profit obtained and the capacity of the unit to give a positive response in a competitive environment specific to market economy imply the managerial ability to hold in and control the costs of the developed activity.*

*In our research we set the goal of studying the expenditures generated by the production activity of heterogeneous type units, in which the pursuance of expenditure using calculation articles is difficult. In order to reach this goal we investigated the organization and costs management on agricultural sector units, mainly on vegetable glass house.*

*In these units it is difficult to segregate the direct expenditure generated by raw materials and other materials, on types, while the manual labor costs are indirect costs. Eventually we propose an organizational, accounting,*

*costs and expenditure pursuance methodology that will ensure, at managerial level, the opportune information needed for decisional act of activity's further evolution.*

*The informatics of costs pursuance activity can give a dully working lever for organizations management. The informatics approach of the aspects treated in this paper work, in authors opinion, can be done by using integrate informatics systems or by makings of specific informatics applications. The authors realize a definition of suitable economic and organizational contexts to one or other solutions. Likewise, are described aspects and effects of one or other solutions implementation.*

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The goal of activity displayed by lucrative units is to obtain profit, seeking permanently its maximization. The profit obtained and the capacity of the unit to give a positive response in a competitive environment specific to market economy imply the managerial ability to hold in and control the costs of the developed activity.

Knowing the costs and using the offered information in the decisional process implies the organization and leading the financial administrative accountancy in accordance with the conditions from each company, the activities' particularity and not in the last, about the objectives followed by the managerial team [2].

Referring to the organization of the financial administrative accountancy, the inuring legislation says: "Trading companies, national societies, researching institutes, co-operative societies and the other juridical people have the obligation to organize and lead a proper accountancy, respectively a financial accountancy proper the law and a financial administrative accountancy adapted to the specifics of the activity" [1].

The methods' and procedures' choice implies the particularities' knowledge referring to the population structure, the technological process, the bounds and dependences between the fabricated products, the possibilities of selection, processing and data improvement referring to expenses and costs.

Our investigation followed the organization and costs management on agricultural sector units, mainly on greenhouses;

From the specific elements from these enterprises which influence the costs organization, we mention:

- The organization disposes of organizational structures whose activity, as duration in time is different: the hot greenhouses, closed, with continual production; cold greenhouses where the production process is seasonal, field production with seasonal production process, but with bigger duration in time and dependent on climatically conditions;
- Some arrays are obtaining entirely from sowing to the harvest in the same organizational structure; at others the production process is retracing in two organizational structures: the sowing is done in the hot greenhouse and the seedling is passed in the cold greenhouse or in the field; the tracing and the expenses' registration must correspond to this situation;
- The structure and the expenses level differs from an organizational structure to another: there are common expenses like: water consumption, the general expenses of administration, the expenses with productive staffs' wages and salaries, and so on; but ordinary expenses too, whose level differs in very large limits: electricity expenses, expenses with gas consumption who are very high in the hot greenhouse especially in cold season; the seed as row material is retrieving with high value in the hot greenhouse, where the seedling is



prepared for solariums and field crop and with a smaller value on the field crop.

- The expenses with work forces differs in very large limits from a period of the year to another, the top being touched in April – September, and the minimum in November – Mars, this determines the existence of a large number of floaters;
- The price of products capitalization is imposed on the market but it differs for the same product and in accordance with the period between the harvest to utilization, for some products (salad, dill, parsley), unutilization in the first two days from the harvest determining their drawing out from the market, so real loss for the companies; in order to avoid these loss, the salesmen are obliged to practice oscillating prices adapted to the real market conditions even in the time of the same day. The price in some cases may be even smaller than the costs at which the products were obtained.

The existing particularities from these companies determine some particularities in the organization, calculation and costs following [3].

At the investigated units we found out that there are two directions on this line.

- On the stage of the plan, through income and expenses budget, there is estimated, through calculation the product cost, on products groups; the calculation base represents the consumption from the past year. The leaving point represents the surface is going to be cultivated with each crop, the production estimated in tones, the estimated consumption per final production and through the method of simple division, there is estimated the production cost and the selling price [2];

The income and expenses evolution is followed monthly, without being a comparison between the mainly indicators which determine the profit,

respectively: the stipulated cost, the effectively cost, the income realized from the product sale.

In our investigation we followed the expenses structure on elements of expenses as it is organized on profile units and the weight of different expenses.

	<b>Absolute Costs</b>	<b>Relative Costs</b>
1. Material Expenses	1088	10,88%
2. Combustible Expenses	380	3,80%
3. Gas Consumption Expenses	90	0,90%
4. Water consumption Expenses	179	1,79%
5. Postal expenses, telephone	25	0,25%
6. Electricity Expenses	463	4,63%
7. Seed and Planting materials expenses	567	5,67%
8. Salaries and Wages Expenses	4559	45,59%
9. Insurances and Social Protection Expenses	1655	16,55%
10. Transport Expenses	202	2,02%
11. Other Operating Expenses	300	3,00%
12. Taxes Expenses	12	0,12%
13. Depreciation	480	4,80%
<b>TOTAL</b>	<b>10.000</b>	<b>100%</b>

The analysis of expenses structures on elements shows, the small weight of expenses with raw material (5,67%), with materials (fertilizers, pesticides) 10,88% and the raised weight of insurances and social protection 62,14%.

We consider that it would be good, for the unit, a modality through which you can follow and know in every moment the estimated expenses, the effectively expenses and their weight in both cases. This would be

possible through the implementation of some specific elements destined to this intention.

The elements' computerizing which compose the production costs in greenhouses must ensure to the management information in real time upon them.

Gathering, processing, hoarding and data' remittance referring to following the costs on greenhouses can be realized in two ways [6]:

- Through some integrated informational systems;
- With specific independent applications

The implementation of some specific independent applications approaches the problems of following the production costs through three modulus: the production following modulus, management bookkeeping modulus and decision holder modulus. As a rule, the modulus which ensures the information decision holder represents an operative processing of data giving the executive management daily dates about costs' evolution.

The most modern integrated informational systems works at the level of decision holder modulus with specific technologies for processing the data' cubes. These technologies are known as OLAP (Online Analytical Processing). The advantage of this technology is that once the processing data model is defined the processing results as reports, indicators and graphics actualize immediately in accordance with the modification of operative data.

The specific independent applications represent informational programs or simple modulus which records the costs and presents their evolution toward target level and on costs elements. The most used instrument for the implementation of an informational model fated to the following the costs in the production greenhouses is the component of tabelar calculation "Excel" from Microsoft Office.

The advantage of a specifically informational application is the fact that this can be realized exactly on the specific demands of the user, it can adapt easily to his needs and it isn't very expensive (about 500 € with Excel license). In this case it is better that the user (manager or specialty staff) to have the necessary knowledge to use the Excel.

There can be realized sophisticated programs with elements of self-learning that hoards and analyze the data on more periods of time, can make predictions of the costs or of other cost's elements in accordance with other cost's elements or of production. This way you may control the process of administrating the resources which represent elements of cost (water, temperature, fertilizers and so on).

Following the costs in real time offers to the decisional system, elements of control, foresight and regulation.

If we dispose of performant systems of observing the parameters for the plants growing in greenhouses (water system, fertilizers administration, heating, humidity, and so on) we may connect these systems directly as terminals for data introduction in the application of costs' following.

Highlighting and following the expenses on elements, inclusively their weight per total, would permit the knowledge at the end of each line of the expenses elements where were recorded overfulfilment and causes investigation, that generated it.

The causes that are generating the majority of the expenses may be subjective or objective. Between the subjective, there are the one caused of an inefficient management, at company level or at organizational structure, and these can be known and eliminated. The problems are impossible or almost impossible to solve when the increasing expenses are owed to some objective causes, external which are in some cases, governmental decisions with important effects upon the expenses level. I am mentioning, between

these, the increasing value at usefulness – marsh gas, electricity, which can't be foreseen in the foreseeing. The program we propose would permit the enterprise to know in every moment the weight it has the expenses element affected on the external measures; governmental and adjustment, of the sale prices. This would permit the knowledge of the percentage to which every extern factor influences the rise of cost and at case the suitable increasing of the sale price or profit diminishing, for reasons independent on managerial politics. Using the informational program permits the simulation of some politics cost – sale price which to offer different variants to production – cost – sale price, with choosing the best variant from those three perspectives.

Another problem which draws our attention was following the efficiency on those three technical – organizational subunits: hot greenhouses, cold greenhouses and field crop. We consider that in the account 902 “Internal clearing concerning the obtained production” would be recommended the opening of three syntactical accounts of second degree on each subunit, and in the credit account to register the sum realized from selling the products at sale price, and in the debit account the effectively cost, the expenses generated by production realization. This would permit (with small adjustment) determining the difference between the products cost and the sum received from their sale, a very important information for appreciating the measure in which the selling price covers the production expenses and the activity efficiency of each technical – organizational subunits.

Highlighting the cashing from selling the products on subdivisions requires some organizational measures like: elaborating the delivery documents differentiated on technical – organizational subdivisions, the retail to be made only on sales slip in which to be mentioned the product name so that to be possible the registration in financial administration

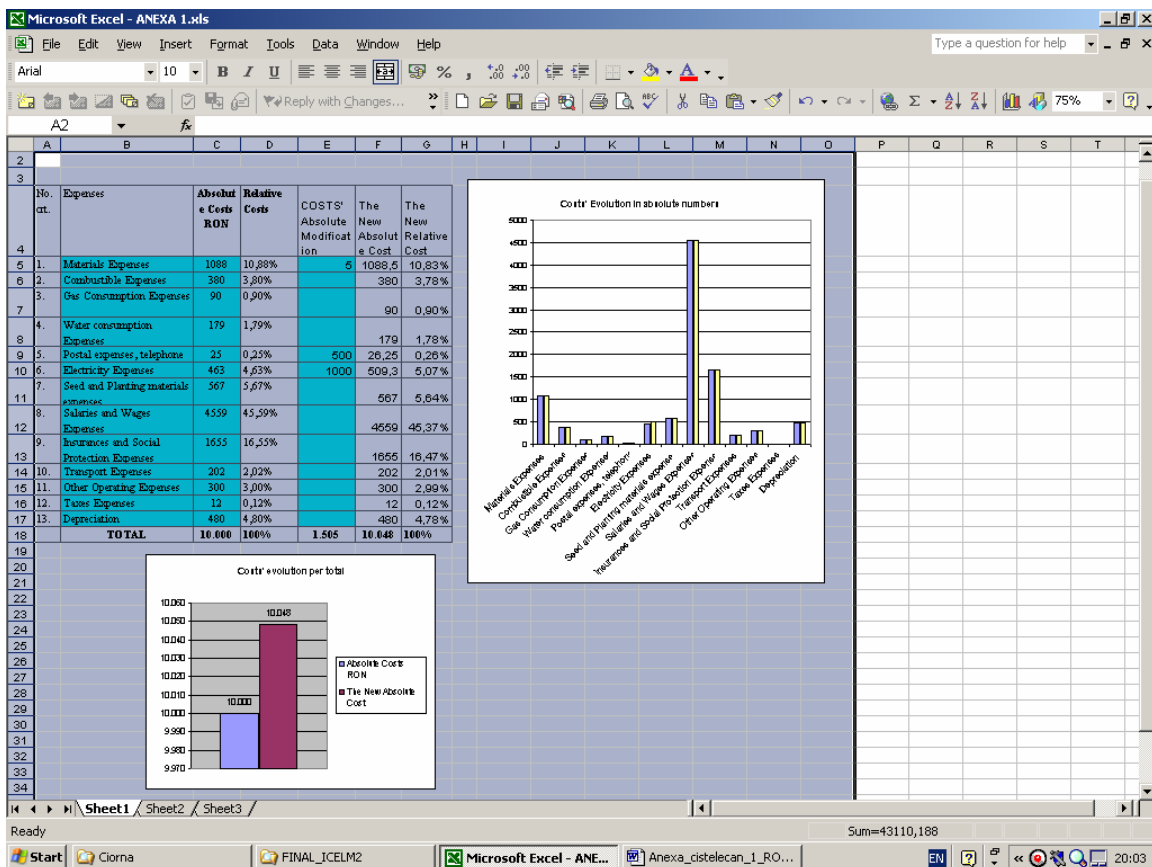
accountancy, in the credit account 902 “Internal clearing concerning the obtained production” of the cashing resulted from selling the products on each subdivision [4].

The organization and leading the costs accountancy with the help of informational programs elaborated on the presented procedures would permit following the cost evolution on expenses elements so that the manager would base his decisions on correctly and appropriate information.

The information from the account 902 “Internal clearing concerning the obtained production” permits the efficiency appreciation of each technical – organizational subunit and of the contribution which these bring to the realization of company profit.

Apendage no. 1

COSTS' FOLLOWING IN GREENHOUSES



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## ASSURANCE SERVICES VERSUS AUDIT SERVICES

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*The need of assurance is required by business practice. There are different forms of organizing public interest for satisfying the demand of assurance. The person that provides assurance must be independent and impartial in relation with the users of the information that is examined. Audit corporations are able to perform both assurance and non-assurance services. The two types of services overlap when the quality of information constitutes the main purpose of rendering them.*

Investors need independent assurances regarding financial informations and performance's indicators of the entities. The accountants who are employed and are under their managers' order offer financial information through the financial situations made with responsibility by them, but there is need of other professionals' endorsement appreciated by the investors because of the following issues:

- Their own economic, technical, judicial knowledge;
- Their own independence regarding the interests of other users of the financial situations;
- Their suggestions given to the companies regarding the profit's increase and the operational efficiency's improvement.



These professionals' services – the auditors' ones – offer assurances regarding the information's concordance with the norms and settlements on this sphere and with the reality of the carried on operations, transactions.

The need of assurance is required by business and public life practice. It is not new. There exist numerous and various forms of judicial organization in public life created in order to satisfy the request for assurance like:

- Public services which are decentralized  
E.g.: The consumer's protection which publish the result of the evaluation of products' quality by offering assurances to the consumers.
- Non-profit organizations, entities which estimate different domains in order to offer to the public assurance's services:
  - the assurance of the standards of quality control ISO 9000;
  - the assurance regarding the observance of the norms, the laws referring to the protection of the surroundings;
  - the evaluation and the effectuation of TV and radio programs' classification;
  - politicians and commercial procedures' assurance, the evaluation of the risks in a commercial agreement;
  - the assurance of the observance of the author's rights for the entertaining programs;
  - the assurance offered by the expert accountants, auditors through:
    - the services of the financial situations' certification;
    - other types of services like:
      - ❖ the assurance of different games and contests' development in a impartial manner and according with the rules established by lotteries;
      - ❖ assurances regarding the veracity of financial previsions, of the control mechanisms in an entity, etc.

In the future, the request for the assurance services will increase according to the development of the anticipated information's request and of the quantity of information offered to the public through the internet.

Generally, the increase of the request for the assurance services takes place as a sequel of realizing the decision factors in entities regarding the utility of the assurance services for the improvement of the information relevance which is used in the process of taking decisions.

Assurance services are valuable because the person who offers the assurance is independent and impartial from the information he/she is evaluating.

The types of services offered by the companies from the accounting domain may be classified from the assurance's point of view as follows:<sup>1</sup>

- services with a character of assurance;
- services which do not have a character of assurance.

#### **I. The services with a character of assurance may be grouped in:**

##### A. Certification services which include:

1. the audit of the financial historic situations;
2. the revision of the financial historic situations;
3. others services of certification (asked by the bank, regarding the efficiency of the internal control, etc.);

##### B. Other services with a character of assurance:

1. the assurance of the information' technology;
2. the assurance of other kinds of assurance.

#### **A. Certification services:**

1. **The audit of the financial historic situations** has the following characteristics:
  - It is the predominant form of the services with a character of assurance offered by the audit companies;
  - It is compulsory for the opened societies or other entities according to the legislation used in this domain;

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<sup>1</sup> Loebbecke, Arens, *Audit – An integrated approach*, the 8<sup>th</sup> edition, Chişinău : ARC Publishing House, 2003, – pg. 7 – 8.

- In most of the cases, it is assessed by the financial creditors (banks, etc.);
- It offers a high grade of assurance;
- It is finally done by sending a report where it is stated the opinion regarding the concordance of the significant aspects of the financial situations with the accounting principles generally accepted;
- The users rely on the audited financial situations when they take decisions, making reference to the auditor's report like to an indicator of that situations' veracity.

**2. The revision of the financial historic situations** is a service of assurance requested by the entities which are not obliged to effectuate audit, which do not want to support an audit's costs and, though, want a certain assurance on the information in the financial situations. Its peculiarities are:

- To offer a moderate assurance regarding the financial situations, necessitating less probative information in order to justify this level of certification;
- asking for less money than an audit.

**3. Other services of certification** may be required by:

- Banks, in order to observe certain financial clauses in the loan-contracts;
- Shareholders, the administrative council in order to test the efficacy of the mechanisms of internal control;
- Financers, for the provided financial situations in order to obtain finances, etc.
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#### **B. Other services with a character of assurance**

These ones can not be included in the certification services' definition even if specialists (accountants, auditors) who effectuate them must be independent in order to give an assurance regarding the information used by the decision factors.

They are different from the certification services because they do not require imperative the effectuation of a written report and the assurance does not aim at the fidelity of a written declaration of a third person, referring only at information's

relevance and correctness (characteristics which may or may not be declared by a third person).

At this kind of services, specialists, accountants, auditors are confronting with a harsh rivalry because of other experts.

**E.g.** the evaluation of the correctness of the information given by the market's studies where specialists, accountants, auditors are vying with the firms which offer services in the market's studies' domain.

Even so, the advantage of the audit societies on the market of the assurance services is assured by their reputation on this field, by competencies and auditor's independence.

Other services with a character of assurance aim at the need of assurance of the traditional services' users (institutional clients, physical persons) for other types of information than the historic financial information necessary in the process of taking decisions.

For this type of assurance The American Institute for Authorized Public Accountants (A.I.C.P.A.) created the Special Committee of the Assurance Services (Elliott Committee) whose aim is to develop different opportunities of services with a character of assurance.

The committee first report was published in 1997 as a virtual one accessible only on The American Institute for Authorized Public Accountants' web-site. The report includes the result of the studies in this domain.

In the future, the requirement for these services will rise because of:

- the new types of risks the business world is confronting with;
- the increase of the number of information sources which are asked for;
- other types of services like:
  - the assurance of the informational technology;
  - the assurance of other kind of information.

**1. The services of informational technology's assurance** are requested because of the development of the internet, of the electronic trade (e-commerce).

They appeared are developed because of the fact that:

- payments and orders are made through the internet – on-line – having as aim the transmitted data and the security of transaction;
- it requests the utilization of web-sites which implies assurances on the control mechanisms that are in use.

The category of the services of informational technology's assurance includes:

- a. the services of the electronic commerce's assurance;
  - b. the services of the assurance of the informational systems' correctness.
- a) the assurance services effectuated for economic transactions made through the internet are called *Assurance Services CPA Web Trust* and the societies or bookkeeping examination obtained here a license for carrying out the services. Helped by an electronic seal *Web Trust* attached to the web-site by the specialist, these services offer the security that the web-site's owner is in concordance with the pre-established criteria through the practice assuring the integrity of transactions and informational processes.

*Web Trust* is a service of certification and its seal is a symbolic representation of the report made by the specialist after he had analyzed the management's declarations about its own practices related to the electronic commerce.

- b) the services of the assurance effectuated by expert accountants referring to the informational systems' correctness give the opportunity to observe, on the one hand, if the informational system is made and used on a way that it can generate correct data and, on the other hand, if it is protected against the factors which cause errors in data.

If the assurance services *Web Trust* offers assurances to the web-sites' users, the services regarding the correctness of the informational systems offers assurances to the management and to the third persons that the data are correct and delivered in a real time.

**2. The assurance services of other kind of information include:**

- a. Services of economic performances' valuation;
- b. Services of valuation of medical services' quality;

c. Services of some events' valuation.

a) Services of economic performances' valuation

The economic performances' valuation by the financial situations' users require more complex activities than the ones offered from the historic financial situations. Measuring the economic performances with the performance's indicators included in the board's chart is a necessary thing for the managers for the definition of the entity's goal and objects:

- a larger number of clients;
- more satisfaction given to the customers;
- the incomings' increase;
- the patrimony's increase; etc.

For this thing the managers introduce valuation systems of the performances on which the expert accountants offer the assurance that:

- financial and non-financial information reported by the valuation system of the performances are correct;
- performance's indicators assurance a concrete orientation to the strategic goals and objectives.

b) Services of valuation of medical services' quality done to the old persons.

When offering the assurance of the medical services' quality the expert account plays the role of a coordinator of these activities using specialists from the medical field.

c) Services of some events' valuation like giving prizes at conquests for : miss, the man of the year, the best director, national lottery etc.

All of these are supervised by bookkeeping services' firms in order to assure the audience that these conquests took place according to the rules and without frauds.

**Remark:** maybe you will not win an Oscar, but being an employee of an audit firm you may have the chance to participate at the Oscar awarding of prizes.

**II. Services which do not have a character of assurance include:**

- Accountancy services and services for managing the registers;

- Fiscal services;
- Services for managerial consultation.

The services for managerial consultation have an area of superposition with the services which have an assurance character. The difference between consultation and assurance services is made because of the goals of each type of service.

Consultation services' aim is to make recommendations to the management meanwhile the assurance services have in view to improve the quality of information.

Information's quality is an important criterion in a consulting contract, but it is not the basis goal of the consultation.

E.g. an auditor may be employed according to a consulting contract in order to transform the ideas for a business in a business. In this case, the aim is to realize a business, the qualitative information being just a low-result of the contract.

The two types of services are superposed when the quality of the information represent the main goal of the consulting contract.

The services of consultation made by the audit firms have increased significantly and due to this thing they have created departments involved exclusively in services of managerial consultation.

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# LIFE INSURANCE PRODUCTS AND ECONOMIC DEVELOPMENT

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*Every person possesses at a given moment in time a certain patrimony made up of his or her entire amount of goods, or other valuable objects he or she owns. Any person approaches these belongings in two main ways: 1 – Patrimony Maintenance – which refers to financial patrimony protection against certain events whose occurrence could lead to a decrease in its value (by property insurance, and life insurance, respectively); 2 – Patrimony Development – which means the increase of the total value of a person’s belongings as a consequence of different investments, including life insurance with an endowment policy.*

*But taking out life insurance in order to maintain and develop personal patrimony has not only microeconomic effects (at individual level), but also these effects, on their turn, have consequences at the level of the entire economy. More concretely, those who buy such a financial service maintain and even stimulate the demand for goods and services, which represents the “engine” of business development in any economy.*

## **I. People’s Approaches towards Individual Patrimony**

Independent of age, sex, education, occupation, or living area, almost everyone in the world possesses at a given moment in time a certain **patrimony**. The size, value, and “make-up” of that fortune vary, of course between individuals and moments in time. However, most of the times,

personal patrimony is made up of the entire amount of goods or other valuable objects owned by the person, such as: one or more houses (apartments), one or more cars, works of art, jewelry, home appliances, financial resources directed to different placements.

At the same time, any person approaches these belongings in two **main ways**:

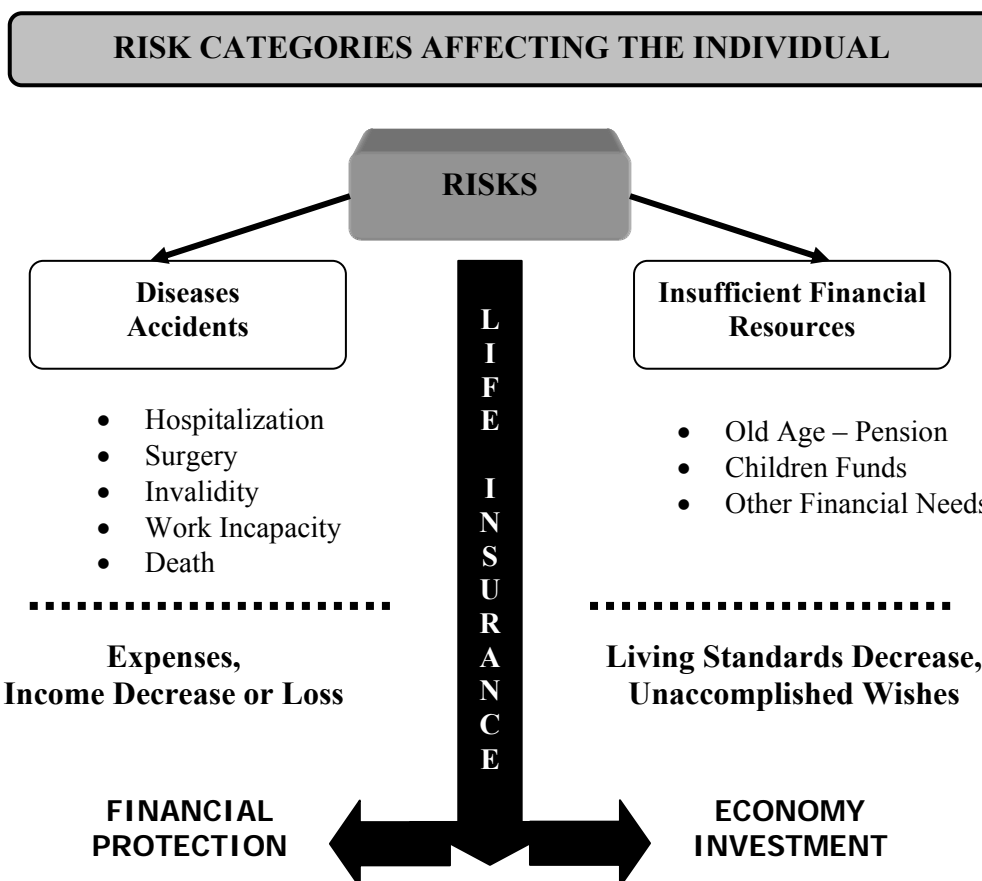
**1. Patrimony conservation** - which refers to financial patrimony protection against certain events, whose occurrence could lead to a decrease in its value. The two most used patrimony conservation manners are property insurance involving all the elements that make up a person's fortune, and life insurance taken by the person who owns the goods, respectively. For example, if a person's car is stolen, his or her patrimony decreases by the value of that vehicle (for example, EUR 25,000); if the property is protected by car insurance, the insurance company has to give compensations to its client amounting to the exact actual value of the car (EUR 25,000), which means that, although the risk of theft has occurred, the person's patrimony value has remained unchanged, being conserved.

**2. Patrimony development** - which means the increase over time of the total value of a person's belongings as a consequence of different investments made in bank deposits, investment funds, public securities, bonds, shares, life insurance with an endowment policy, private pension funds, real estate investments (land, buildings), etc. Thus, if every such placement generates a certain profit (taking the forms of interest, dividends, or rent), the fortune of the person who owns all these elements increases with time.

We should also mention that these two main types of individual approach (patrimony conservation and development) are determined by the existence of two main types of risks concerning each individual, which, if they occur, cause serious problems and inconveniences to the involved parties. More concretely, we talk about<sup>1</sup>:

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<sup>1</sup> The author's own approach to the types of risks affecting people.



**A) The risk of disease or accident occurrence** – as a result of the occurrence of any of these cases, the respective person would need hospitalization, surgery, he or she could become an invalid, or even die; financially all these cases determine, on one side, expenses, and, on the other side, a decrease in or even the loss of income made by the individual affected by the risk.

**B) The risk** that, at certain times in life, a person does **not** have sufficient **financial resources** in order to reach his or her goals, times such as:

**a)** Retirement time – when the lack of financial reserves that would be added to the state pension affects the living standards of the respective person, standards that significantly decrease;

**b)** Certain wishes concerning the children in the family (education, car, or house funds), or other personal objectives (a special vacation, a new car, a larger house, business development, etc.) – all these require large amounts of money, which, if not available, make the desired goals impossible to attain.

Under these conditions, the life insurance products represent financial services whose role is to diminish or even eliminate the negative effects of personal risk occurrence. More concretely, we can say that **life insurance** performs **two** extremely precise **functions (roles)**:

- 1<sup>st</sup> Function – **Financial protection**;
- 2<sup>nd</sup> Function – **Endowment** (Economy / Investment).

And the concrete ways by which life insurance products perform these functions, and further the ways in which they contribute to the country's economic-financial development process are the themes that will be largely discussed in the following paragraphs.

## **II. Life Insurance Products' Contribution to Achieving the Financial Protection Necessary to Individuals, and its Effects on Economic Development**

When an individual becomes seriously **ill** or is the victim of a bad **accident**, a series of major financial problems occur:

**a)** The respective person may need *hospitalization, surgery, and specific treatment*; all these involve, on one side, a temporary income decrease regarding the risk affected person, and, on the other side, expenses, which are most of the times very large;

**b)** The disease or accident may also lead to (temporary or permanent, total or partial) *invalidity*, case in which constant medical care is required, as well as treatment, all of which mean more expenses; moreover, invalidity may mean that the respective person can no longer work (temporarily or permanently), which determines additional financial problems generated by the decrease in / loss of the income earned by the sick person;

**c)** Last but not least, a disease or an accident may lead to the death of the risk affected person; in this case, the financial difficulties are determined by two different

situations: the expenses the family of the deceased person has to make at the time of death (the costs involved by organizing the funeral ceremony, fees paid by the heirs, and other expenses), as well as the loss of the income earned by the deceased person.

As far as the **impact** of such unwanted events **on economic development** is concerned, the income decrease leads to:

**1. A decrease in consumption and investments** made by the family whose member is affected by the disease or accident;

**2.** The decrease in demand generates a reciprocal reaction on the market, which on turn leads to a **decrease in the supply** of different provided **goods and services**, situation which

**3. Negatively affects the country's economic-financial development process.**

It is, however, evident that **the overall effect generated by the few number of families whose one or more members become ill or suffer from accidents annually does not basically affect a country's economic-financial evolution, but the phenomenon is present and has reduced global effects.**

In order to **act against** these particular **negative** (individual and global) **financial effects** of diseases and accidents, **life insurance products** provide their buyers with the so-called **FINANCIAL PROTECTION**: a substantial fund (a large amount of money called SUM INSURED) that has two **main purposes**:

- **Covering the expenses** generated by hospitalization, surgery, or different types of treatment, so that these costs were not born out of the insured's or his or her family's own financial resources;
- **Replacing the income** that is lost due to work incapacity or death, for a certain period of time, so that the living standards of the risk affected person or his or her family remained unchanged until viable financial recovery solutions could be identified.

In conclusion, independent of the unwanted events that occur in a person's and his or her family's life, and usually generate financial difficulties, **the existence of a life insurance product** leads to a decrease in or even disappearance of these problems, and allow the maintaining of the current living standards (including consumption habits). And as far as the impact on the economic-financial environment is concerned, it is reduced or even eliminated; therefore, **the country's economic development process is not negatively affected.**

### **III. Life Insurance Products' Contribution to the Accumulation Process of Financial Resources Necessary to Individuals, and its Effects on Economic Development**

As it has already been said, **the second category of personal risks** that may affect a person and his or her family is constituted by the **lack of adequate financial resources** at certain times in life, which could make the living standards of the respective person decrease, or some very important wishes remain unfulfilled. More concretely, these cases refer to:

**A)** The time of **retirement**, when state pension becomes the main income source of most of the people who cease their professional activities; then a real problem occurs because in most countries the state pension system does not provide sufficient income for maintaining the living standards at least at the level of the active period.

In Romania as in other countries in the world, the state pension system cannot adequately answer people's needs anymore. Although it was efficient when first introduced, the state pension system generates income that currently does not allow people who cease their professional activities to maintain their living standards at least at the level held before retirement.

First implemented in Otto von Bismarck's Germany (at the end of the 19<sup>th</sup> century), **the state pension system** worked according to a simple scheme: every active person

had to contribute some of his or her income to a state budget centralized fund, which was used to pay people who had ceased their professional activities and, consequently, had no income source.

However, the changes that have occurred over the years (including in our country), both in the economic, and in the social life, have made this mechanism stop working as well as it did when first implemented. Here are the main reasons that have led to a dramatic decrease in the level of state pensions provided to the population:

- The decrease in the percentage of active vs. non-active people (the number of those who contribute to the pension fund). For example, in 1989 in Romania 6 active people contributed to the income of a retired person, while in 2002 the proportion was 1 to 1, and in 2003 there were about 4 million active persons and approximately 6.5 million retirees;

- An increase in the age at which people start working and begin contributing to the Fund (this phenomenon occurs as young people increasingly pursue academic and postgraduate studies and postpone starting their working life);

- Average life expectancy has increased over time (meaning that the period of time during which a retiree has to be supported by the Pension Fund is increasing).

**B)** The lack of an adequate **fund** to be used at **financially supporting children's studies** or **other** of their **needs** (such as buying a house, starting a business, etc.) evidently affects the fulfillment of these objectives.

**C)** The same applies to the fulfillment of **other wishes** of a person and his or her family, such as **buying a house**, starting or developing a **business**, or **meeting other needs**.

The **impact** of such unwanted events (the decrease in the living standards at retirement time, and the failure to fulfill needs related to children or other personal objectives, respectively) **on the economic environment** is represented by the following:

1. **A decrease in consumption and investments** made by the retired person or by the family with insufficient financial resources;
2. The decrease in demand generates a reciprocal reaction on the market, leading to **a decrease in the supply** of different provided **goods and services**, situation that
3. **Negatively affects the country's economic development process.**

Compared to the relatively reduced negative impact that the occurrence of a disease or accident has on the economic environment (due to the small number of people affected by these risks), this case is different. And that is because **the number of retirees and families with insufficient financial resources is currently extremely large** in Romania; therefore, **the effect of this situation on the economic-financial environment is also extremely substantial.**

In order to **act against** these **negative** (individual and global) **financial effects** generated by the lack of sufficient financial resources at different times in a person's life, some **life insurance products** offer their buyers the so-called **ENDOWMENT POLICY (relating to individual PATRIMONY DEVELOPMENT)**: the opportunity of accumulating a substantial fund over time, fund that has at least **three main purposes**:

- **Starting private pensions** that would be added to the state pensions, providing the respective persons with financial support that is absolutely necessary in order to maintain or even increase living standards after retiring from the professional activities;
- **Accumulating funds** that are necessary for fulfilling different needs related to **children**, such as financing their studies, buying them a car or an apartment;
- **Accumulating financial resources** that are necessary for fulfilling **other wishes** of the respective person and family, such as buying a larger house, starting or developing a business, objectives that can be accomplished under the conditions of adequate financial support.



All life insurance products that pay a certain amount of money at the end of the contract may be used as an excellent method of starting an additional pension that will be added to the state pension. As the value of state pension is very difficult to estimate and control (we do not know how many active people will there be in, for example, 20 years, what their income will be, how many retirees will have to be paid out of the Pension fund), **private pension obtained by means of life insurance**<sup>2</sup> gives the special **advantage** that every person can decide its particular level. Thus, if the contribution to such insurance is substantial, so will be the value of the private pension, and if the contribution is smaller, the benefits will be as such.

Another **major advantage** of a placement in a life insurance policy as compared to investments in bank deposits, securities, or other investment forms is **investment protection**.

For **example**, let us discuss the case of a person who will need a certain amount of money in 10 years in order to **finance his or her children's studies**.

If the respective person chooses to gradually accumulate money in a bank placement, there is a risk that the accumulation process might stop in case the respective person becomes ill or suffers an accident that prevent him or her from working (making money). Moreover, the respective person might have to appeal to the resources that he or she has already accumulated in the bank account in order to cover the expenses generated by the unwanted events. Consequently, he or she can no longer accumulate the desired amount of money.

In case the money is invested in life insurance, the situation is very different. Even if the previously mentioned events occur, the insurance company will cover all the necessary expenses, without deducting the payments made during the duration of the policy from the benefits to be paid at the end of the contract. Consequently, the entire

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<sup>2</sup> We should distinguish between the **optional** private pension system that is represented by life insurance products (the system we are discussing in these paragraphs and that is already at work) and the **compulsory** private pension.

amount of money the client desires to have in 10 years remains intact, independent of the events that occur during that time.

Obviously, before making any placement, the client-investor should thoroughly analyze the creditworthiness of the insurance company with which he or she intends to place their financial resources. We should emphasize here that the elements that any investor should analyze before making a placement are reliability, profitability, as well as investment liquidity.

In **conclusion**, at the most important times in life the **living standards** of an individual or his or her family may **remain unchanged** or **even increase** as the endowment policy (the patrimony development component) of life insurance provides the buyer of such a service with the financial resources necessary to fulfill different wishes related to children (education, house, etc.), or other family needs (a better house, a better car, special vacations, starting or developing a business). All these actually determine:

1. An **increase in the market demand** for different goods and services, situation that will
2. **Encourage the production** of such merchandise, and thus the **business development** of the companies producing it, all these leading to
3. **The stimulation of the country's economic development.**

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## CONSIDERATIONS REGARDING THE RECOGNITION AND EVALUATION OF GOODWILL

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**Abstract:** *The paper puts forward the analysis of the specific way of recognition and evaluation of the goodwill and its correlation with the applied requirements of the recognition of the elements of financial statements in general. More exactly, the purpose of our step is to clarify, for correct application, the specific notions and, at the same time, the applied ways of recognition and evaluation of the classified elements as goodwill.*

*The goodwill may affect significantly the comparability of the financial statements between different companies that use different accounting methods. Under these conditions, the user of the financial-accounting information must possess the knowledge necessary to eliminate any possible deviation that could be created by the goodwill, its recognition, amortization and impairment.*

*On the other hand, the enactment of the International Financial Reporting Standard (IFRS) 3 Business Combinations replacing IAS 22, which is outdated, improves the process of evaluation of the goodwill, offering at the same time more consistency to the theoretical presentations which define its particularities, accounting treatment, presentation, interpretation and specific analyze.*

There are many interpretations given to goodwill.

In general, from the point of view of accountancy the goodwill is known to represent an intangible asset, which contributes to the maintenance and development of the potential of a company's activity. It is represented by customers (customers' fidelity and attitude towards the firm, the capacity of attracting new customers due to market expansion, customers' number and quality, etc.) the quality of the relations with the suppliers (the quality of the services and of the goods delivered by the suppliers, the possibility to select the suppliers, etc.), outlets, reputation, etc.

According to the Accounting Regulations harmonized with the European Directives, approved by the Public Finances Minister's Order no. 1.752/2005 the goodwill "appears - as a general rule - at the consolidation and it represents the difference between the cost of acquisition and the value at the date of transaction, of the part from the net assets acquired by an entity".

The goodwill may be under the form of goodwill or badwill.

More exactly, the goodwill appears when the cost of a group of companies is superior to the quota given to the buyer from the net fair value of identifiable assets, liabilities and contingent liabilities of the acquired company. It is actually a payment made by the buyer due to the anticipation of the future economic benefits. These benefits may result from the synergy of the purchased identifiable assets or of the assets which individually are not qualified to be recognized in financial situations, but the buyer is ready to pay for them within the acquisition. Thus, it may be said that the goodwill is represented by some virtual assets.

On the other hand, badwill appears when the cost of the acquisition of the titles is inferior to the quota given to the buyer from the net fair value of the identifiable assets, liabilities and contingent liabilities of the acquired company.

Once we made clear what goodwill is and what its forms are, the obvious question to ask is: How will goodwill affect the financial statements of the company?

We mentioned above the fact that goodwill is represented by virtual assets. Under these conditions it seems logically to include this goodwill in the category of intangible assets.

Regarding this aspect, in the special literature there are different opinions concerning the recognition and evaluation of the goodwill, and one of the most important problems that arise is if this totally accomplishes the criteria of recognition of the assets.

One of the arguments against the recognition of the goodwill is given by the fact that it does not satisfy, firstly, the definition of the intangible assets.

Thus, according to IAS 38 Intangible Assets, the application of the criteria of the recognition of the intangible assets generates the following definition of these: an intangible asset is an identifiable nonmonetary asset, without physical substance, which is separable and which arises from contractual or other legal rights, that is capable of being separated from the entity and sold, transferred, licensed, rented or exchanged - either individually or together with a related contract, asset, or liability and that is clearly distinguishable and controlled separately from the entity's goodwill.

The same Standard specifies that the goodwill cannot be sold separately from the acquired entity, so it does not have a separable character, for it may be identified only as a difference. In addition, the norm also specifies the fact that the goodwill generated internally (from its own resources) must never be recognized as assets. An entity may have expenses with the purpose to generate future economic benefits, but if an intangible asset does not have a result in order to satisfy the criteria of recognition of IAS 38, it is often described as a contribution related to the goodwill generated internally. This is not recognized as an asset, because it is not an identifiable resource controlled by the entity with a cost which could be measured credibly. Consequently, it does not respect the definition of assets according to the International Accounting Standards.

Another argument against the recognition of the goodwill would be the fact that it cannot be evaluated for a certainty, except for the moment of grouping the entities. Later, its value is determined through appraisals, appraisals which are based on the appraiser's assumptions. As such, the value of the goodwill is subjectively determined.

The subject of recognizing the goodwill in the financial statements has found, besides the opponents whose arguments were presented above, proponents, too, among the professionals. The proponents of the recognition of the goodwill affirm that this would really represent the present value of the excess returns that an entity could obtain. This group claims that determining the present value of these excess returns is analogous to determining the present value of future cash flows associated with other assets and projects.

Each of the two groups, because of their well-formulated arguments, has its merits.

As it is the case with the recognition and evaluation of the goodwill, the accounting regulations from our country regarding the accounting treatment of this have not kept up with the new existent trend at the international level either. Then, it is very well known the fact that different accounting treatments applied according to the professional judgment generates distinct influences upon the results.

Both in the accounting practice and theory the following main methods for the treatment of the goodwill have crystallized:

- maintaining the goodwill in the asset without amortizing or provisioning;
- imputing the goodwill to its own capital;
- capitalizing and provisioning the goodwill in the case of the impairment of the acquired assets;
- capitalizing the goodwill and its amortization.

Before IFRS 3, IAS 22 Business Combinations stated that the goodwill had to be amortized systematically during its useful life. The period of amortization had to reflect the best estimation of the period during which the future economic benefits were awaited to be generated by the entity. In this situation it functioned the suggestion – disapproved by the specialists – that the useful life of the goodwill did not have to exceed 20 years from its initial recognition. Then, the used method of amortization had to reflect the way in which the economic benefits arising from the goodwill were waited to be consumed. The linear method was recommended, except

the case in which there was a convincing argument or proof that another method and other duration of amortization were more suitable under the given circumstances.

In addition, the same IAS 22 stated that the entity, at the end of every financial year, had to estimate the recoverable value of the goodwill being amortized during a period exceeding 20 years from the date of the acquisition, even if no clue of its impairment existed. This thing was difficult to put into practice, especially when the goodwill had a long useful life.

The same Standard stipulated a special accounting treatment for the badwill. As long as this corresponded to awaited future loss, loss identified in the acquirer's plan of acquisition, this badwill had to be recognized in the profit or loss account. In the other situation, when the badwill did not correspond to the future loss it had to be recognized at income, thus:

- that part which did not exceed the fair value of the acquired nonmonetary identifiable assets, had to be recognized, systematically, along with the weighted average and the remained useful life of the acquired amortizable identifiable assets;
- the part which exceeded the fair values of the acquired identifiable assets had to be recognized immediately at income.

In accord with IFRS 3, the excess of the cost of acquisition over the acquirer's interest in the fair value of the identifiable assets and liabilities acquired is described as goodwill and is recognized as an asset.

According to the same IFRS, goodwill is not amortized. The goodwill should be tested for impairment annually.

We have already noticed a fundamental change. It is now forbidden the amortization of the goodwill. Then, for the purpose of impairment testing, goodwill should be allocated to each of the acquirer's cash-generating units or groups of cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are allocated to that unit or those units.

At this moment we should clear up what a cash-generating unit represents.

A cash-generating unit is the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.

On the other hand, the excess of the acquire's interest in the fair value of the identifiable assets and liabilities acquired over the cost of acquisition is a gain and is recognized in the profit or loss. This difference is not recognized on the balance sheet as negative goodwill. It is recommended that, before any gain is recognized, the acquirer should reassess the cost of acquisition and the fair values attributed to the acquiree's identifiable assets, liabilities, and contingent liabilities.

The first example

SM (big society) acquired 70% of the common shares of a SF (subsidiary) for the sum of 9.000.000 u.m. (monetary units) on the 1st of April exercise "N". At the date of acquirement the equity of the SF was made of: paid-in capital 7.500.000 u.m., reserves 3.000.000 u.m., resulted 300.000 u.m. The fair value of the identifiable assets and liabilities of the SF resulted after the reevaluation is smaller than the accounting value with 2.250.000 u.m.

To be demonstrated the result of the acquisition:

- thousand u.m. -

The cost of acquisition of the titles		9.000
Paid-in capital	7.500	
Reserves	3.000	
Resulted	300	
The difference between the fair value and the accounting value of the acquired assets and liabilities	(2.250)	
Equity evaluated at the fair value	8.550	
Quota of the equity evaluated at the fair value, which belongs to SM ( $8550 \times 70\%$ )		(5.985)
Goodwill		3.015



We would like to mention that while determining the goodwill the deferred taxes were not taken into account.

The accounting treatment for a business combination may be different from the fiscal treatment. Under these conditions some differences may appear between the fair value of the assets, liabilities, acquired identifiable contingent liabilities and their base of taxing. Thus, according to IAS 12 Income taxes, while counting the business combinations, we should take into consideration the deferred tax, too.

When the control over an entity, more exactly the power to govern its financial and operating policies, is obtained following the successive acquisitions of titles, each transaction should be treated separately with the purpose of determining both the fair value of the assets, liabilities, acquired identifiable contingent liabilities and the value of the goodwill.

The second example

SM takes over the control of the SF after two successive acquisitions of titles, thus: on the 1st of January exercise “N” acquires 30% of the titles for the sum of 500.000 u.m., and on the 1st of July the same exercise 40% for the sum of 800.000 u.m. The value of the equity of the SF on the 1st of January was of 1.500.000 u.m., and on the 30th of June of 1.750.000 u.m. We assume there is no difference between the accounting value and the fair value of the assets, liabilities and contingent liabilities of the SF.

- thousand u.m. -

The equity at the fair value at the moment of the acquisition of the titles			Cost of acquisition	Goodwill
Total	% acquired	Quota acquired from the equity at the fair value		
1.500	30%	450	500	50
1.750	40%	700	800	100

The things presented in this paper reinforce through their nature the fact that goodwill represents in accountancy a very complex and highly controversial subject

at the same time. Then, the information provided by the entity through the financial statements it produces is at the base of some very important decisions both for the entity's management and for the users of the information. Consequently, we should be able to distinguish between the economic goodwill and the accounting goodwill. The economic goodwill is based on the economic performance of the entity. The accounting goodwill has at its bases the accounting standards. Thus, we consider that it is good while analyzing the financial situations of an entity to eliminate the goodwill from the balance sheet. The excess returns obtained by an entity will reflect in the price of the common shares.

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# **ACTIFS INCORPORELS ET PARTS DE MARCHÉ LORS DE LA TRANSITION IFRS**

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*For some groups, markets shares can represent more than half of the consolidated balance sheet total. Contrary to the French standards, the norm IAS 38 “ intangibles” does not permit the separate disclosure of market shares within intangibles. The purpose of this article is to emphasize that the use of the IFRS norms would allow a better comparability between the groups regarding this matter.*

*Résumé de l'article*

*1. Au 30 juin 2005, seulement 95 groupes étaient cotés au MID 100.*

*2. L'étude porte, en effet, sur tous les exercices clos depuis la date de publication du règlement européen le 11 septembre 2002. En effet, ci-après, sera étudié comment les groupes français qui avaient des parts de marché à l'actif de leur bilan, à la date de publication du règlement européen, ont traité la divergence comptable entre le référentiel français et les IFRS.*

*3. Depuis le 1er janvier 2005, date de l'application du règlement 2004-06 sur la définition, l'évaluation et la comptabilisation des actifs (CRC, règlement 04-16), le*

*maintien de la position du CNC d'avril 1990 est devenu provisoire dans l'attente de l'alignement du règlement 99-02 sur la norme IFRS 3 et avec les nouvelles règles concernant les actifs (CRC, règlement 04-06) qui ne permettent sur la comptabilisation séparée des parts de marché à l'actif. En effet, le règlement CRC n° 2004-2006 n'a pas précisé les modalités de première application du nouveau traitement des parts de marché acquises lors*

*d'un regroupement d'entreprises et indique que ces modalités feront l'objet de dispositions ultérieures (CRC, règlement 04-06 art. 17). Le groupe de travail "Actualisation du règlement. 99-02" du CNC examine notamment ce point et les évolutions qui en résulteraient pourraient être applicables à partir de 2006.*

*4. Toutefois, les relations clients non contractuelles répondent à la définition d'une immobilisation incorporelle lorsqu'elles font l'objet de transactions d'échange. A titre d'exemple, nous verrons, ci-après, le cas de Thomson.*

*5. Accor et Groupe Gascogne n'ont pas communiqué sur le passage des parts de marché aux IFRS. Concernant Accor, la responsable de la communication financière nous a indiqué que les parts de marché ne sont pas significatives (0,6 % du total du bilan fin 2004), c'est la raison pour laquelle aucune information ne figure sur la transition en la matière. Toutefois, nous avons été informés que les parts de marché seraient reclassées en "Ecart d'acquisition". Concernant le Groupe Gascogne, le directeur financier ainsi que le responsable des normes nous ont informés que les parts de marché seront reclassées en écarts d'acquisition lors de la transition aux normes IFRS.*

*L'étude des rapports annuels et documents de référence des groupes cotés en France au CAC 40, au NEXT 20 et au MID 100 met en évidence l'hétérogénéité de la communication en matière de traitement des parts de marché.*

*L'analyse des parts de marché inscrites à l'actif du bilan des comptes consolidés, sous le référentiel français (CRC, règlement 99-02) met en évidence que pour certains groupes elles représentent plus de 50 % du total du bilan. Cette possibilité d'inscription à l'actif qui était très utilisée par les groupes avant la publication du règlement 99-02 a été maintenue en dépit de la divergence avec les*

*IFRS (IAS 38 – Immobilisations incorporelles et IFRS 3 – Regroupements d'entreprises).*

*La plupart des regroupements d'entreprises répondent à l'objectif d'accroissement des parts de marché. L'acquisition est le mode principal de regroupements d'entreprises dans lequel l'acquéreur prend le contrôle de l'actif net et des activités d'une autre entreprise. En France, les conséquences sur les résultats dépendent du traitement comptable retenu par les groupes dans leurs comptes consolidés. Il en résulte que la comparaison des performances n'est pas toujours aisée.*

*Après l'identification des principaux groupes cotés en France qui inscrivent des parts de marché à l'actif de leur bilan consolidé, puis le rappel des textes français et des normes IFRS en ce domaine, il a paru utile de présenter les traitements de ces actifs incorporels lors de la transition IFRS.*

## **Groupes présentant des parts de marché à l'actif de leur bilan consolidé**

L'échantillon pour cette analyse est basé sur les groupes cotés en France au CAC 40, au NEXT 20 ou encore au MID 100(1) au 30 juin 2005. Ainsi, cette étude repose sur l'examen des rapports annuels et / ou documents de référence relatifs aux comptes consolidés et sur l'analyse de la documentation disponible sur les sites Internet de 155 groupes pour les exercices 2002, 2003 et 2004. Seulement 29 groupes, sur la population étudiée, ont présenté des parts de marché à l'actif de leur bilan consolidé au moins une fois pour les exercices 2002, 2003 et 2004 (2).

Tableau 1 : poids des parts de marché dans les bilans consolidés des  
29 groupes en 2002, 2003 et 2004

Groupes	2004 (millions d'€)	% Total bilan 2004	2003 (millions d'€)	% Total bilan 2003	2002 (millions d'€)	% Total bilan 2002
ACCOR	75	0,6	75	0,7	75	0,7
BACOU DALLOZ	282	29,9	300	27,6	349	27,6
BOLLORE	8	2,8	8	3,0	8	2,9
BOUYGUES	4358	17,5	5064	20,2	4387	17,7
CAPGEMINI	1055	18,1	678	11,2	724	12,3
CASINO	956	6,1	965	6,3	965	6,2
CIMENTS FRANÇAIS	594	12,2	635	12,9	696	13,3
EIFPAGE	82	1,3	73	1,2	55	0,9
ELIOR (a)	183	9,5	183	9,5	183	9,3
ESSILOR	57	2,2	54	2,2	64	3,0
FININFO	24	13,0	24	14,6	24	15,0
FRANCE TELECOM	3232	3,4	3204	3,2	3560	3,3
GEODIS	53	2,8	67	3,9	77	4,3
GASCOGNE	4	0,8	4	0,8	4	0,8
LAFARGE	2270	9,2	2421	9,8	2603	9,8
L'OREAL	1061	5,8	1024	6,8	1137	7,6
NEOPOST (b)	281	21,5	281	22,7	264	19,9
P.P.R.	7349	31,6	6104	24,8	5523	18,4
RALLYE	965	5,2	965	5,5	965	5,4
REXEL	224	6,4	229	6,3	261	6,4
RUBIS	165	30,2	186	33,9	186	33,4
SODEXHO ALLIANCE (c)	2410	31,5	2556	31,5	2794	32,7
STERIA	93	14,1	93	12,6	93	12,2
THOMSON	374	4,4	397	4,3	393	4,1
TOUPARGEL AGRIGEL	91	50,2	91	44,7	7	12,4
UNILOG	10	2,0	4	0,9	4	1,0
VINCI	63	0,3	79	0,4	114	0,6
VIVENDI	1030	2,4	2827	5,2	2903	4,2
VEOLIA	499	1,4	1227	3,2	2284	5,4

(a) clôture au 30 septembre

(b) clôture au 31 janvier

(c) clôture au 31 août

Ce tableau met en évidence que les parts de marché peuvent peser plus de 50% du total de l'actif du bilan consolidé, c'est le cas du groupe Toupargel-Agrigel en 2004. Ce tableau met également en lumière que depuis la date de publication du règlement européen relatif aux normes IFRS, le 11 septembre 2002, le montant des parts de marché des sociétés appartenant à

l'échantillon n'a pas évolué de manière significative sur la période 2002 à 2004. Ainsi, les groupes de l'échantillon n'ont pas reclassé les montants inscrits en parts de marché dans le poste "écarts d'acquisition" entre 2002 et 2004. Sur la base des montants inscrits en immobilisations incorporelles, nous pouvons conclure que les groupes n'ont pas traité de façon anticipée la divergence comptable entre le référentiel et les normes IFRS avant l'exercice d'adoption (exercices ouverts à partir du 1er janvier 2005).

En quoi consiste cette divergence ?

### **Les textes comptables relatifs aux parts de marché**

La divergence entre le référentiel comptable français et les normes IFRS concernant les parts de marché peut être résumée comme suit.

#### **Référentiel comptable français**

Le règlement 99-02 (§2111) a confirmé la position du Conseil national de comptabilité (CNC) d'avril 1990 selon laquelle les parts de marchés constituent des actifs identifiables si elles respectent certains critères (3). Ainsi, dans le cadre d'une prise de contrôle, un élément incorporel acquis doit être considéré comme un actif identifiable si la société peut l'évaluer séparément selon des critères objectifs et pertinents fondés pour l'essentiel sur :

- les avantages économiques futurs que l'élément permettra de générer
- ou sur la base de sa valeur de marché lorsqu'il existe un marché actif pour des biens similaires ;
- ou, à défaut, sur d'autres méthodes faisant référence aux pratiques du secteur concerné.

Par ailleurs, la société doit pouvoir suivre l'évaluation de cet élément incorporel dans le temps afin de déterminer l'évolution de la valeur à la clôture des comptes annuels et d'enregistrer une dépréciation, le cas échéant.

Les groupes qui n'avaient pas la possibilité de suivre ces valeurs ont enregistré ces éléments en écarts d'acquisition et pas en parts de marché. Or, ce classement



n'est pas sans conséquence sur le résultat consolidé. En effet, les écarts d'acquisition sont amortissables alors que les parts de marché ne le sont pas. En revanche, elles peuvent être dépréciées. Dans la pratique, sur la période étudiée, peu de groupes ont constaté une dépréciation de leur part de marché.

### **Normes IFRS**

La problématique de la norme IAS 38 réside, d'une part, dans les critères de reconnaissance d'un incorporel comme un actif et, d'autre part, dans la comptabilisation de cet actif. Cette norme, qui est en cours de révision par l'IASB, a pour objectif d'indiquer le traitement comptable, les modalités d'évaluation et les informations à fournir au sujet des immobilisations incorporelles. La norme IAS 38 s'applique à toutes les

immobilisations incorporelles non traitées spécifiquement par d'autres normes. Elle définit une immobilisation incorporelle comme étant un actif non monétaire identifiable sans substance physique détenu en vue d'une production ou d'une fourniture de biens et services, pour la location à des tiers ou pour une utilisation propre à des fins administratives. La norme rappelle (IAS 38 §7) qu'un actif est une ressource contrôlée par une entreprise du fait d'événements passés et dont les avantages économiques futurs sont attendus par l'entreprise. Par ailleurs, la norme IAS 38 impose que cette immobilisation incorporelle soit identifiable du *goodwill*. Pour satisfaire aux critères d'identifiabilité, elle doit être séparable de l'entreprise acquise et doit faire l'objet de protection légale ou contractuelle (4).

En normes IFRS, comme en principes français, les éléments incorporels liés aux clients peuvent, en général, être comptabilisés séparément des écarts d'acquisition ou *goodwill*.

Cependant, selon les normes IFRS et contrairement aux principes français, il n'est pas possible de comptabiliser séparément des écarts d'acquisition les relations clients non contractuelles ne

faisant pas l'objet de transactions d'échange, comme par exemple les parts de marché, ces éléments étant

considérés comme insuffisamment contrôlés pour répondre à la définition des immobilisations incorporelles.

Toujours selon la norme IAS 38, les immobilisations incorporelles à durée d'utilité définie sont amortissables. En revanche, celles dont la durée d'utilité est indéterminée ne doivent pas être amorties et selon la norme IAS 36 – Dépréciation d'actifs, un test de dépréciation doit être effectué à chaque fois qu'il existe un indice selon lequel l'immobilisation incorporelle a perdu de la valeur. Les immobilisations acquises dans le cadre d'un regroupement d'entreprises sont traitées dans le cadre de la norme IFRS 3, qui a remplacé la norme IAS 22. Selon la norme IFRS 3, un test de dépréciation doit être systématiquement réalisé sur les écarts d'acquisition même s'il n'existe pas d'indice de perte de valeur.

## **La communication sur le traitement des parts de marché**

L'analyse de la communication des 29 groupes étudiés permet de mettre en lumière les pratiques hétérogènes en matière de traitement des parts de marché, lesquelles sont enregistrées dans 12 postes différents de l'actif, comme le montre le tableau 2.

### **• Présentation des parts de marché à l'actif du bilan consolidé selon le référentiel français**

Tableau 2 : rubriques utilisées pour les parts de marché dans les bilans consolidés des 29 groupes en 2002, 2003 et 2004

1. Marques, parts de marche et fondseditoriaux
- 2 Droits de propriete intellectuellt et commerciale
  - 3 Margues,parts de marche fonds commerciauxes,
  - 4 Enseignes, marques, parts de marche
  - 5 Positions commerciales
  - 6 Clienteles
  - 7 Bases d''abonnes

Groupes	Parts de marche	Immobilisations incorporelles	Concessions, brevets, marques, parts de marche	Ecarts d'aquisition	Marques parts de marche	1	2	3	4	5	6	7
ACCOR	x											
BACOU DALLOZ			x (a)									
BOLLORE				x								
BOUYGUES		x										
CAPGEMINI	x											
CASINO	x											
CIMENTS FRANÇAIS	x											
EIFFAGE		x(b)										
ELIOR			x (c)									
ESSILOR								x				
FININFO		x (d)										
FRANCE TELECOM												x(e)
GEODIS				x								
GASCOGNE	x											
LAFARGE										X		
L'OREAL			x									
NEOPOST	X											
P.P.R.									X			
RALLYE	X											
REXEL	x											
RUBIS	X											
SODEXHO ALLIANCE	x											
STERIA	X											
THOMSON							X					
TOUPARGEL AGRIGEL											x	
UNILOG			x (f)									
VINCI		X										
VIVENDI UNIVERSAL						x						
VEOLIA					x							
<b>Total</b>	<b>11</b>	<b>4</b>	<b>4</b>	<b>2</b>	<b>1</b>	<b>1</b>	<b>1</b>	<b>1</b>	<b>1</b>	<b>1</b>	<b>1</b>	<b>1</b>

(a) Poste "Marques, parts de marché et brevets"

(b) Poste "Autres immobilisations incorporelles"

(c) Poste "Concessions, marques, parts de marché"

(d) Poste "Autres immobilisations incorporelles"

*(e) France Télécom, a procédé à une nouvelle analyse des parts de marché qui ont été classées en “Bases d’abonnés”, selon le référentiel français, au 31 décembre 2004. Jusqu’en 2003, les montants étaient inscrits en “parts de marché”.*

*(f) Poste “Brevets, marques, droits et valeurs similaires”*

En conclusion, il apparaît que le référentiel français ne permet pas une comparabilité aisée.

## **• Présentation des anciennes parts de marché à l’actif du bilan consolidé selon le référentiel IFRS**

Au cours du premier semestre 2005, la majorité des groupes cotés européens, conformément aux recommandations des régulateurs boursiers, ont publié une information chiffrée relative à 2004 sur leur passage aux normes comptables internationales IFRS.

Les informations communiquées par les groupes sur le traitement des parts de marché pour la transition IFRS montrent que 27 groupes (5), parmi les 29 de l’échantillon, vont reclasser les montants correspondant aux parts de marché, avec le référentiel français, en écarts d’acquisition à l’occasion du passage aux normes IFRS.

Les deux groupes qui n’ont pas procédé au reclassement en écarts d’acquisition sont France Télécom et Thomson. Ils ont procédé à une analyse du contenu des parts de marché qui leur permet de conserver les montants correspondants parmi les immobilisations incorporelles, selon le référentiel IFRS, en 2004.

En effet, pour France Télécom, ainsi que nous l’avons vu, pour anticiper le passage aux IFRS une nouvelle analyse des parts de marché a été effectuée. Ainsi, les bases d’abonnés viendront se substituer en IFRS aux parts de marché pour leur montant net d’amortissement.

Par ailleurs, Thomson, dans son document de référence 2004, mentionne que ces parts de marché correspondant à des “relations contractuelles avec les clients” répondent à la définition d’actifs incorporels selon IAS 38. Les informations recueillies proviennent du document de référence 2004

Il n'a pas été possible d'élaborer un tableau mettant en évidence le nouveau poids des montants inscrits en écarts d'acquisition correspondant aux "anciennes" parts de marché, par absence d'information concernant les montants dépréciés. La valeur brute des parts de marché ne changera pas avec la transition aux IFRS. En revanche, les écarts d'acquisition ne sont plus amortis car ils feront l'objet de tests de dépréciation avec les normes IFRS et il n'existe que très peu d'informations relatives aux impacts de ces tests dans la documentation étudiée.

\* \* \*

En conclusion, cette analyse permet de mettre en lumière les pratiques homogènes des groupes français en matière de traitement des parts de marché grâce à l'application des normes IFRS. L'impact différent sur le résultat consolidé en fonction du classement des parts de marché, observé dans la pratique selon le référentiel français, n'existera plus. Ainsi, une lecture plus facile des comptes va permettre une meilleure comparabilité en la matière.

Jean-Jacques JULIAN

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**Site Internet de l'IASB** : [www.iasb.org.uk](http://www.iasb.org.uk)

## **The Fiscal Treatment of Merger**

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*The merger is a way of reorganization. For obtaining benefits companies are put in some decisional situations about their future. Any company tries to develop, to enlarge the market share. The merger is a complicated operation, with many steps. In economy any company is under fiscal laws. The reorganizational operations, which includes merger are guided by fiscal rules. The fiscal threatment of merger is reglementated in Romania by the M.F.O. no. 1376/2004 about the merger, division, liquidation and their fiscal threatment. The paper present the fiscal threatment of merger, and the taxes which a company implicated in merger has to pay.*

In economic literature there are many definitions about enterprises merger. The notion of merger is a notion about reorganization of enterprises. For reaching the main object, the profit, an enterprise has to take many decisions about the future. An enterprise tries to increase her market rate in connection with competition or at least to maintain it. This requires suitable concentration strategies or business reduction or even breaking the entity in many parts<sup>1</sup>.

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<sup>1</sup> Carcei, E., *The The Working and Stopping of a Joint-stock Company*, Economic Publishing House, Bucharest, 1996, p.138

So, the merger is an operation whereby one or more entities decide to transfer their patrimony to another entity and to develop their activity together. The merger is one of the capital concentration form<sup>2</sup>.

The merger has taken place in a long period of time and supposes a long preparation, during are studied the financial conditions of merger.

About the taxation system, a long period of time the merger was vague presented. Although the juridical frame was established by Law no. 31/1990, the taxation rules weren't presented. A few aspects about merger taxation were presented in Law no. 414/2002 about income tax.

The procedural, accounting and taxation forecasts were presented also in M.P.F.O. no. 1223/1998 which soon was abrogated and replaced by M.P.F.O. no. 1078/2003. This order elucidated a few aspects about merger taxation.

In 2004 appeared M.P.F.O. no. 1376/2004 for approving The methodological rules about merger, division, dissolution, liquidation of entities and about excluding an associate and their fiscal threatment. This order replaces the old rules and is based on Fiscal Code approved by Law no. 571/2003.

The merger is submitted by the next rules:

#### 1. Income tax

The Fiscal Code treats in Title II, art. 27 the taxation of a few reorganizations forms, through is merger too. So, the Fiscal Code specifies that in merger between two or more juridical entities, when shareholders of any merging entity acquire shares in the new entity, there are the next rules:

- the assets and liabilities transfer is not a taxable transfer
- the exchange of shares held at a romanian juridical entity for shares held to another Romanian juridical entity is not a taxable transfer
- the tax value of an asset or liability is equal for the person who obtain that asset is equal with fiscal value of the asset at transferring entity

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<sup>2</sup> Dumbrava, P., *Patrimonial modifying*s, Universitary Press Publishing House, Cluj Napoca, 2004, p.26



- the tax value of shares obtained by an entity should be equal with fiscal value of the transferred shares
- the transfer of a provision or a reserve is not considered a reduction or cancel of the provision or reserve if another entity takes those and maintain those at the same value
- if a romanian juridical entity holds over 25% of another Romanian juridical entity shares which transfers assets and liabilities to the first entity through merger, the cancel of the shares is not a taxable transfer.

The Fiscal Code clarifies also the tax value term. The tax value of an asset, a liability or a share is the value which is used for calculating the depreciation or profit or loss. The fiscal depreciation is calculated according to art. 24 from Fiscal Code.

The legal reserve is deductible in a limit of 5% of net profit before determination of the income tax, minus non-taxable incomes plus expenses of these, until de 5<sup>th</sup> part of subscribed and paid-up capital. If the reserve is used for adjustment or for distribution the reconstitution of reserve is not deductible anymore. The reserve of juridical entities which supplies utilities for the reorganization entities can be used for adjustment of shares from changing debts.

Also, decreasing or canceling of any provision or reserve which was previously deducted is included in taxable incomes, indifferently if the decrease or cancel is about modify the provision destination or reserve or the provision or reserve is distributed to the merging entities.

The incomes for assets transfer are non-taxable incomes and the demise assets expenses are non-deductible expenses.

## 2. Dividend tax

For equity elements of net profit ( reserves, net profit for previously exercises which was not distributed ) the dividend tax is calculated and payable in case of merger.

## 3. Value-added tax

Value-added tax is owed for goods delivery , which according to art. 128 from Fiscal Code is any transfer of goods deed from the owner to another person, directly or through persons acting in the owner's name.

In the same article, alin. 5 specifies that goods transfer made as assts and liabilities transfer in merger is not goods delivery indifferently if is with payment or not.

#### 4. Fiscal losses

Fiscal loss who is registered by the tax payers ceases to exist through merger is not recuperated by the new company or by acquiring company.

Fiscal loss registered by acquired company until the date on which merger takes effect is adjusted.

In European law the system of taxation applicable to mergers is settled by the Directive issued in 1990.

According to M.P.F.O. no. 1376/2004 the taxable treatment of merger is different by merger's form.

In merger by acquisition the taxable system is:

##### a) at the acquired company

The incomes from assets transfer, in account 7583 "Revenues from disposal of assets and other capital operations" are non-taxable incomes. Also, expenses from disposal of assets, account 6583 "Expenses from disposal of assets and other capital operations" are non-deductible expenses.

The acquired company transfers to the acquiring company assets and liabilities at their tax value, based on the value used for depreciation calculation, without reevaluations and accounting values, the depreciation is going to be made in the left period.

The decrease or cancel of any provision or reserve previously deducted at payable profit calculation is taxable income, except when the acquiring company takes the provision or reserve.

The financial statements and payment of income tax has to be made 10 days before publishing date when merger takes effect.

b) at the acquiring company

Fiscal loss at the acquired company is not recuperated by the acquiring company.

For determination of taxable profit the assets and liabilities tax values are used, same values at the acquired company. If the tax value from the acquired company is not known for the acquiring company this value is zero.

If in the transfer are provisions or reserves previously deducted these are included in taxable incomes. Also, if the legal reserve value is over 1/5 of capital, the difference is not a taxable income if the reserve is maintained at the same value.

In merger by formation of a new company are the next taxable rules:

a) at the ceases companies

Like in merger by acquisition, the assets transfer incomes are non-taxable incomes and the expenses are non-deductible expenses.

The ceases companies transfers to the new companies the tax value of assets and liabilities, calculated without reevaluations and accounting values.

The decrease or cancel of any provision or reserve previously deducted at payable profit calculation is taxable income, except when the acquiring company takes the provision or reserve.

The financial statements and payment of income tax has to be made 10 days before publishing date when merger takes effect.

b) at the new company

Fiscal loss at the acquired company is not recuperated by the acquiring company.

For determination of taxable profit the assets and liabilities tax values are used, same values at the acquired company. If the tax value from the acquired company is not known for the acquiring company this value is zero.

If in the transfer are provisions or reserves previously deducted these are included in taxable incomes. Also, if the legal reserve value is over 1/5 of capital, the difference is not a taxable income if the reserve is maintained at the same value.

So merger is an important operation of reorganization in our days. All the operations are governed by many rules, through taxable rules. Every company has to pay taxes, and merging companies too.

The taxable system is very important and also very changeable in our days, for this the merging companies, the managers of these companies must know the taxable system of merger.

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# **THE IMPACT OF DIGITAL MONEY ON FINANCIAL ENVIRONMENT**

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*Beyond electronic banking or electronic brokerage, the financial sector is intimately involved in the broader realm of electronic commerce in its role as enabler of online payments for transactions between businesses, consumers, and governments. The fast-paced global environment of both the electronic and physical worlds' demand that financial intermediaries offer easy-to-use payment tools that allow rapid electronic funds transfer across borders. However, the more anonymous real-time business environment also demands a high degree of client verification as well as security and authentication of funds transferred. Financial partners or payment vehicles that cannot deliver both these services will not be competitive.*

At the present juncture, the development and use of electronic banking and electronic money are still in their early stages. Electronic payment media are likely to figure importantly in the development of electronic commerce. While providing new opportunities for banks, electronic banking and electronic money activities carry risks as well as benefits and it is important that these risks are recognised and managed in a prudent manner.

While existing risk management principles remain applicable to e-banking activities, such principles must be tailored, adapted and, in some cases, expanded to address the specific risk management challenges created by the characteristics of e-banking activities.

The integration of e-banking applications with legacy systems implies an integrated risk management approach for all banking activities of a banking institution. To this end, it is incumbent upon the boards of directors and banks' senior management to take steps to ensure that their institutions have reviewed and modified where necessary their existing risk management policies and processes to cover their current or planned e-banking activities.

Each bank's risk profile is different and requires a tailored risk mitigation approach appropriate for the scale of the e-banking operations, the materiality of the risks present, and the willingness and ability of the institution to manage these risks. This implies that a "one size fits all" approach to e-banking risk management issues may not be appropriate.

Given the degree of uncertainty about future technological and market developments, it is important that supervisory authorities avoid policies that hamper useful innovation and experimentation. There are a couple of documents as an initial step in an ongoing review and discussion of supervisory issues and responses related to technological advances in electronic retail products and services. The document has the expectation of facilitating the development of appropriate supervisory approaches to the management of risks in electronic banking and electronic money activities.

The report focuses attention on the need for effective Home supervision of cross-border e-banking activities. There are plenty report identifying bank's risk management responsibilities with respect to cross-border e-banking. It supplements last year's risk management principles published by the Basel Committee, providing both obligations and suggestions for bank and supervisory action. We can note that cross-border e-banking has not developed as rapidly as domestic e-banking in most countries due in large part to customers' perceptions regarding the safety and security of e-banking transactions with foreign institutions and banks' concerns regarding

uncertainties with respect to national jurisdiction, choice of law and consumer protection requirements for cross-border e-commerce transactions.

Specifically, the principles indicate that banks should conduct risk assessments of the cross-border aspects of e-banking activities, particularly those related to potentially different regulatory and legal requirements. In addition, banks should provide sufficient disclosures on their websites so that potential customers can identify the bank, its Home country, and its regulatory licenses.

The guidance generally stresses the need for international cooperation in order to promote safe and sound cross-border e-banking without creating undue regulatory burdens or impediments to the delivery of banking services on-line.

The principles appear well-crafted given the nature of cross-border e-banking and the challenges it poses for Host country supervision. Whether the principles are sufficient to address a broader set of issues (e.g., consumer protection; fraud) remains to be seen in practice. Such issues may not be subject to the bilateral Home and Host supervisory relationship as contemplated under the Basel Concordat.

Technological innovation and competition among existing banking organisations and new entrants have allowed for a much wider array of banking products and services to become accessible and delivered to retail and wholesale customers through an electronic distribution channel collectively referred to as e-banking. However, the rapid development of e-banking capabilities carries risks as well as benefits.

It is expecting for such risks to be recognised, addressed and managed by banking institutions in a prudent manner according to the fundamental characteristics and challenges of e-banking services. These characteristics include the unprecedented speed of change related to technological and customer service innovation, the ubiquitous and global nature of open electronic networks, the integration of e-banking applications with legacy computer systems and the increasing dependence of banks on third parties that provide the necessary information technology. While not creating inherently new risks, the Committee noted that these characteristics increased and modified some of the traditional risks associated with banking

activities, in particular strategic, operational, legal and reputational risks, thereby influencing the overall risk profile of banking.

In the futures technical solutions are to be addressed by standard setting bodies as technology evolves. Risk management principles and sound practices identified in this paper are expected to be used as tools by national supervisors and implemented with adaptations to reflect specific national requirements and individual risk profiles where necessary. However, some issues, such as the management of outsourcing relationships, security controls and legal and reputational risk management, warrant more detailed principles than those expressed to date due to the unique characteristics and implications of the Internet distribution channel.

The board of directors and senior management are responsible for developing the institution's business strategy and establishing an effective management oversight over risks, so they are expected to take an explicit, informed and documented strategic decision as to whether and how the bank is to provide e-banking services. The initial decision should include the specific accountabilities, policies and controls to address risks, including those arising in a cross-border context. Effective management oversight is expected to encompass the review and approval of the key aspects of the bank's security control process, such as the development and maintenance of a security control infrastructure that properly safeguards e-banking systems and data from both internal and external threats. It also should include a comprehensive process for managing risks associated with increased complexity of and increasing reliance on outsourcing relationships and third-party dependencies to perform critical e-banking functions.

While the board of directors has the responsibility for ensuring that appropriate security control processes are in place for e-banking, the substance of these processes needs special management attention because of the enhanced security challenges posed by e-banking. This should include establishing appropriate authorisation privileges and authentication measures, logical and physical access controls, adequate infrastructure security to maintain appropriate boundaries and restrictions on both internal and external user activities and data integrity of transactions, records and information. In addition, the existence of clear audit trails for all e-banking



transactions should be ensured and measures to preserve confidentiality of key e-banking information should be appropriate with the sensitivity of such information.

Customer protection and privacy regulations vary from jurisdiction to jurisdiction, banks generally have a clear responsibility to provide their customers with a level of comfort regarding information disclosures, protection of customer data and business availability that approaches the level they can expect when using traditional banking distribution channels. To minimise legal and reputational risk associated with e-banking activities conducted both domestically and cross-border, banks should make adequate disclosure of information on their web sites and take appropriate measures to ensure adherence to customer privacy requirements applicable in the jurisdictions to which the bank is providing e-banking services.

Online financial services, and electronic banking, is growing in Europe and also in all emerging market economies. In nowadays, and most probably in the near future, the german market is the biggest but not the fastest growing market within Europe. Financial institutions have to consider trends in the market in order to survive and prosper in this very dynamic and competitive environment. Online banks dig for continued quantitative growth in account number, transaction, and value of transaction since these factors are essential for valuation of the company at the stock exchange.

The banking and payment systems need to be able to process transactions in real time, both domestically and in multiple currencies on international markets. One way to jump start this internally is to encourage participation in the local market by foreign financial institutions that already have this capability. The technology and knowledge transfers are important to improve domestic activities. Moreover, the partnership between international institutions with technology and local institutions with local expertise brings the domestic institutions into the global network of financial institutions.

Legal and reputation risk, e-banking services must be delivered on a consistent and timely basis in accordance with high customer expectations for constant and rapid availability and potentially high transaction demand to protect banks against business. Banks should also develop appropriate incident response plans, including

communication strategies that ensure business continuity, control reputation risk and limit liability associated with disruptions in their e-banking services. The bank must have the ability to deliver e-banking services to all end-users and be able to maintain such availability in all circumstances. Effective incident response mechanisms are also critical to minimise operational, legal and reputational risks arising from unexpected events, including internal and external attacks that may affect the provision of e-banking systems and services. To meet customers' expectations, banks should therefore have effective capacity, business continuity and contingency planning.

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## **THE ROLE PLAYED BY THE INTERNATIONAL MONETARY FUND IN MANAGING THE FINANCIAL CRISES**

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*At the beginning of the 80`s the international monetary system had to go through crises but the IMF was condemned for its role in the financial crises at the beginning of the 90`s. They proved the risks associated to the sensibility of the financial global markets.*

*The full deregulation in a too rapid rhythm concerning the capital movements with no fulfillment of some previous minimum conditions can be - and has proved to be - dangerous. The lessons that have come out of the financial crises entail the estimation of foreign vulnerability of country before it has come to look for the deregulation of capital movements. Participating at a global market means macroeconomic stability, a healthy financial system and the transparency of economic policies.*

*The financial role of the IMF has to be a unitary one under the reserve of its limited resources. The countries, which have been taking benefit of financial support programs from the Fund for years or decades, are not genuine proofs for the success of the institution. The IMF should try to prevent the situations as those where the countries of the world might become addicted to the funding that is being offered by this body.*

A number of studies examine the catalytic role of IMF financing in helping to restore confidence and a resumption of private capital flows following a crisis. This literature can be viewed as focusing on *crisis resolution*.

*Crisis prevention* is rather different, not least because it refers to what does not happen to private capital flows. The existing literature provides a useful point of departure since some channels through which IMF support may help restore capital inflows following a crisis are likely similar to those through which it may help prevent outflows in the first place.

If IMF support helps prevent crises, the next question is how. The literature on the signaling role of IMF financing provides some clues. This literature emphasizes four channels through which an IMF-supported program may reduce the likelihood of a run, by: providing liquidity; supporting stronger policies; signaling these better policies to financial markets; enhancing their credibility via program conditionality.

Since the 30 billion USD bailout of Mexico in 1995, national currency and financial crises in developing countries have increased, as has the incidence of IMF-led bailout packages. Since 1997 those packages have totaled 280 billion USD for Latin America, Asia, Russia and Turkey. Many of those bailouts and the turmoil in international financial markets resulted in the United States contributing 18 billion USD to massively increase the IMF's resources in 1998.

But the monetary costs of supporting the IMF were not the most important reasons to have opposed more funding. The costs to the global economy are high and the people who are most directly affected by IMF interventions - the world's poor - are those who can least afford it. If the goal is to help developing countries progress economically and to promote a liberal global economy, then, at the very least, rich countries should seek to reduce the IMF's resources and activities.

International financial crises may have brought much attention to the Fund in recent years, but the lending agency's record over the past 50 years has been dismal, as numerous books and studies have documented. The IMF does not appear to have helped countries either to achieve self-sustaining growth or to implement market reforms.

Despite its poor performance, the IMF has proven to be a remarkably resilient institution. When the system of fixed exchange rates ended in the early 1970s, so did the agency's original mission of maintaining exchange-rate stability by lending to countries experiencing balance of payments problems. Instead of closing down, however, the Fund has created new missions for itself with each new crisis, each time expanding its economic influence or resources, or both. On average, the IMF has requested and received an increase in resources every five years.

Although the IMF in theory makes short-term loans in exchange for policy changes in recipient countries, it has not helped countries move to the free market. Instead, the Fund has created loan addicts. More than 70 nations have depended on IMF aid for 20 or more years; 24 countries have received IMF credit for 30 or more years. Once a country receives IMF credit, it is likely to depend on IMF aid for most, if not all, of the following years. That is not evidence of either the success of the IMF's conditionality or the temporary nature of the IMF's short-term loans. The Fund has thus moved away from its original mission of providing short-term balance of payment assistance and has instead fostered dependence on aid. Because of that, the Meltzer Commission has advised that the Fund should stop providing long-term loans. Neither the IMF nor the US Treasury has discontinued that IMF function. Using the IMF to bail out a country experiencing a currency or debt crisis is a bad idea for *three reasons*.

*The first reason* is that it creates moral hazard. That is the more we can expect countries to slip into crises in the future because governments and investors will engage in risky behavior in the expectation that, if anything goes wrong, the IMF will come to their rescue. IMF bailouts are expensive, bureaucratic and fundamentally unjust solutions to economic crises.

There is *another reason* why IMF conditions have little credibility. As we have seen with Russia over the past several years, a country that does not stick to IMF conditions risks having its loans suspended. When loans are cut off, recipient governments tend to become more serious about reform. Unfortunately, when policy

changes are forthcoming, the IMF resumes lending. Indeed, the IMF has a bureaucratic incentive to lend.

*Third*, IMF bailouts undermine superior, less-expensive market solutions. In the absence of an IMF, creditors and debtors would do what creditors and debtors always do in cases of illiquidity or insolvency: renegotiate debt or enter into bankruptcy procedures. In a world without the IMF, both parties would have an incentive to do so because the alternative, to do nothing, would mean a complete loss.

Effective *IMF surveillance* of both global economic risks and national economic policies has been fundamental to that vision from the very start of global economic cooperation. The founders of Bretton Woods recognized that effective surveillance over national policies was critical to the international stability and cooperation on which prosperity and growth depended. The original Articles of Agreement established the importance of exchange of information and gave the Fund authority to hold consultations with countries that had not lifted exchange restrictions. With the eventual collapse of the fixed exchange rate system and the expansion of capital markets, IMF surveillance or oversight over members' policies became the centerpiece of international economic cooperation.

International economic surveillance was rightly seen an essential tool for strengthening crisis prevention and promoting global stability and growth. It offered a unique means to assess national and global economic prospects, to detect vulnerabilities at an early stage, to provide policy advice, and more broadly to promote international economic cooperation. And, following the Second Amendment of the IMF Articles of Agreement in the 1970s, the IMF was uniquely placed to undertake surveillance with its responsibility under the new Article IV to oversee the international monetary system and the economies of what is today a membership of 184 countries.

An effective surveillance mechanism needs to be authoritative, comprehensive, focused, influential and accountable. This is essential in order to ensure that surveillance detects problems at an early stage, has an appropriate impact on members' policies and so helps to strengthen crisis prevention and promote stability

and sustainable growth. This need for effective surveillance is more important in a world of global capital markets both for countries concerned and for the international system. Globalization brings new opportunities but also can open new inequalities that need to be anticipated and addressed in developed and developing countries. Opening up fully to globalization too early and too quickly, without the necessary preparation, is dangerous.

The succession of primarily capital account crises since the mid 1990s raised concerns about the authority, comprehensiveness, focus, influence and accountability of the Fund's surveillance.

First, on its comprehensiveness and focus, a common feature of all the crises since late the 1990s is that they started from weaknesses in their domestic economic policy framework in the fiscal or financial systems often combined with unsustainable fixed exchange rate pegs upon which macroeconomic credibility was pinned. In each country - Thailand, Korea, Indonesia, Malaysia, Brazil, Russia - large and rapid capital outflows exposed inappropriate macro-frameworks and fragile banking sectors, with massive costs for budgets and economies and ultimately their people. But in each case Fund surveillance had not ex-ante stressed the weakness of domestic or financial sector frameworks or questioned the sense of linking credibility so clearly to a fixed peg.

Second, the social impact of crises on countries raised questions about the IMF's approach, its quality of advice and accountability. It was criticized for advocating rapid capital account liberalization and paying insufficient attention to the foundations for stability and growth, for applying a one-size-fits all model that was insensitive to countries' individual circumstances and needs, for advocating policies that served primarily the interests of creditors and for being insufficiently open to outside views and advice.

Third, the frequency of crises raised questions about the influence and effectiveness of the IMF's approach. Traditionally, it had sought to exert influence through peer pressure "behind closed doors". IMF documents and discussions remained confidential, despite the fact that increasingly the rest of the international

community emphasized the role that greater transparency could play in encouraging governments and markets to address risks at an early stage, without compromising candor.

It was put in place *a new framework for global stability*, including: internationally agreed codes and standards for monetary and financial transparency; greater transparency at the IMF itself; stronger cooperation on financial sector issues; crisis prevention and crisis resolution based on a partnership public-private; a stronger focus at the IMF and World Bank on the social costs of crises.

*There has been considerable progress* since then. There is evidence that the risk of contagion from financial crises is less than might have been the case only a few years ago and that investors are beginning to discriminate more between countries.

Emerging markets are also adopting strategies to insure themselves against contagion by, for example, building up reserves or shifting to more flexible exchange rate arrangements. While bond spreads have risen in some countries in Latin America in response to the difficulties, the effect has been much less marked in those countries, which are seen to have the strongest policy framework and there has been little impact on spreads in emerging markets in Asia.

But more needs to be done to educate the private sector and ensure adequate information is available to enable efficient investment decisions to be taken. *There are necessary next steps* on codes and standards, greater transparency, reduced vulnerabilities and institutional changes in order to strengthen IMF surveillance.

Relevant to all countries-rich and poor-covering fiscal policy, monetary policy, banking supervision and other key aspects of public policy, they emphasize the importance of clear and sound long-term policy objectives, a precommitment to long-term stability through institutional arrangements and procedural rules and maximum openness and transparency, providing a foundation for stability in the global economy.

Enhancing transparency is critical to strengthening crisis prevention, helping to ensure that vulnerabilities are addressed at an early stage and strengthening the



accountability of the international financial institutions. Greater transparency would not only benefit countries, but strengthen public confidence in the IMF's policies and operations - making clear the basis for the Fund's findings, opening the Fund up to outside critical review and enhancing its accountability, reputation and credibility.

It is vital to ensure that IMF surveillance focuses on the key risks and vulnerabilities, paying more attention to the sources of growth, exchange rate regimes, medium term debt sustainability and external financing needs.

The availability of IMF resources lowers the likelihood of a crisis. Even though money matters, stronger policies and the credibility of these policies evinced through the IMF's financial support are also important to avoid abrupt private capital outflows. IMF financing as a *crisis prevention* tool is most effective for countries with an intermediate range of economic fundamentals.

The IMF provides financial support to assist member countries in addressing their balance of payments needs. In exchange, the member country commits to implement policies and reforms that would help in restoring external viability. The hope is that IMF support has a *catalytic role*, either by restoring confidence and supporting the return of private capital or by serving as a framework for the provision of bilateral and multilateral official financing.

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# **SINGLE-ENTRY ACCOUNTANCY IN AGRICULTURAL EXPLOITATION OF ROMANIA – AN EFFETE COLLOCATION?**

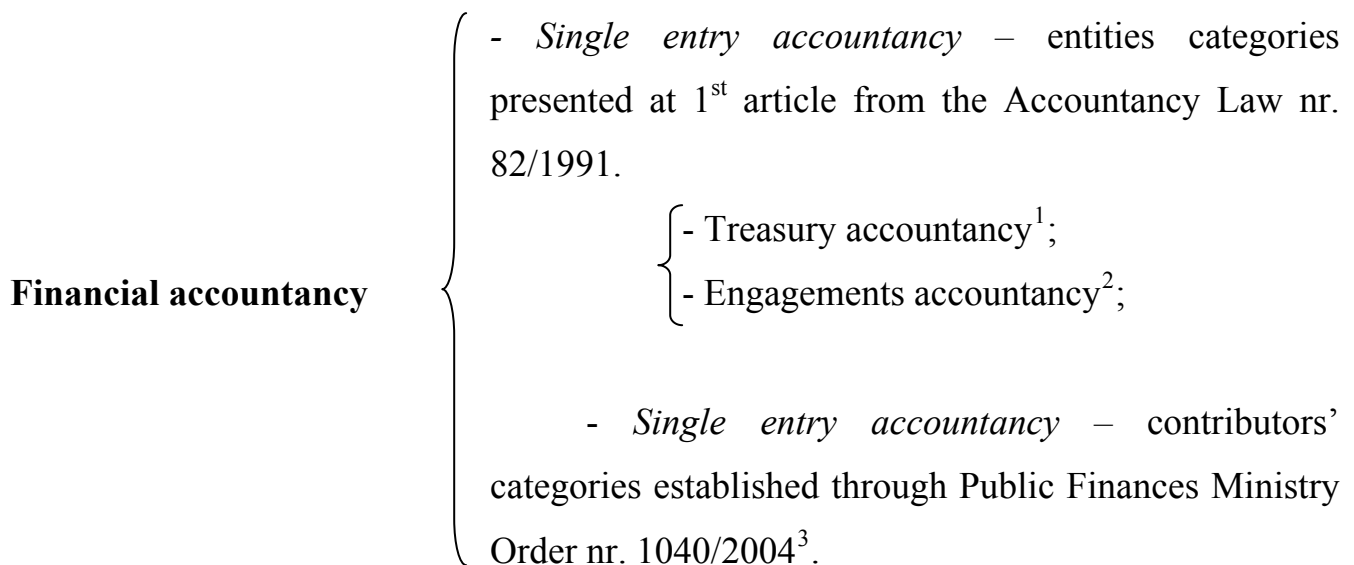
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*Abstract: This paper treats aspects concerning agricultural exploitation and basic elements concerning single-entry accountancy. In the article we present aspects concerning double-entry accountancy in agricultural exploitation and significant information elaboration by models presentation.*

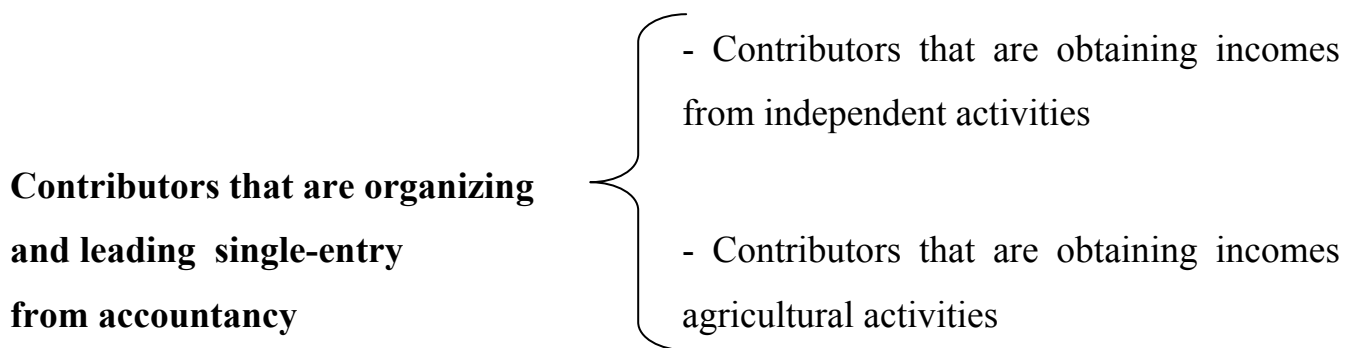
According to Accountancy Law nr.82/1991, republished in the Official Monitory nr. 48/2005, patrimonial entities, which are including also the agricultural exploitations, inclusively the individuals that are developing incomes generating activities, they have the obligation to organize and to lead financial and administrating accountancy.

In the same accountancy law the 5<sup>th</sup> article is stipulating, “the persons categories that can keep single-entry accountancy (our underline) are established through an order of the finance ministry”.

We are presenting as a scheme the area of the financial accountancy and the contributors that are organizing and leading single-entry accountancy:



**Scheme nr. 1. Financial Accountancy's Area**



**Scheme nr. 2. Contributors categories that are organizing and leading single entry accountancy**

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<sup>1</sup> Considering the treasury accountancy, recording the expenses and incomes that are generated in the moment in which operations generates entries or exists of resources that are incorporating economic benefits.

<sup>2</sup> According to this concept, the reflection of the transactions and events has to be recorded from the generating moment.

<sup>3</sup> Contributors that obtain incomes from independent activities. Incomes from the independent activities include commercial incomes, incomes from free professions and incomes from the intellectual property rights, realized individually and/or in an association shape, including adjacent activities. In the methodological norms of the Fiscal Code is presented the fact that persons that are realizing incomes from the presented categories have the quality of physical person and not of juridical persons.

In the accounting plan approved b through Public Finances Ministry Order nr. 1752/2005 there the 8 class “Special accounts” (is presented below), which is containing accounts that are functioning in single entry regime and which have to be used by the entities presented in 1<sup>st</sup> article from the Accountancy Law nr. 82/1991. Single-entry accountancy has to be organized and lead not only by the contributors categories established through Public Finances Ministry Order nr. 1040/2004, but also by the entities presented at 1<sup>st</sup> article from the Accountancy Law.

Single-entry accountancy is assuring the unilateral recording of the economic and financial operations.

Continuing we will present the single-entry accountancy organized by the familial agricultural exploitations.

Familial agricultural exploitations are defined, according to the Urgency Ordinance nr. 108/2001, depending on the maximum dimensions of an entity<sup>4</sup>. These ones have some characteristics that are influencing the book keeping and organization<sup>5</sup>:

- Reduce patrimony existence;
- Simple patrimony administration through surpassing the owner quality with the administrator for a single person;
- Predominance of the familial lab our force;
- The owner has to dispose of vary technical and economic knowledge as well as a rich experience that will allow finding viable solutions regarding the accomplishment of an efficient administration of the resources existing in the patrimony.

Single – entry accountancy in the familial agricultural exploitations can be organized by using the following documents categories:

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<sup>4</sup> A. For the vegetal sector: a. cereals, technical and medicinal plants: plain area 110 ha, heal area 50 ha; b. natural fields cultivated with forages for the mountain area 25 ha; c. vegetables 2 ha; d. tree area and nursery 5 ha; e. strawberries and fruits trees 1 ha; f. noble wineries, nurseries and hop 5 ha; g. glass houses and solar 0,5 ha;

B. For the animal sector: a. milk cows 15 heads; b. fattening cattle 50 heads; c. sheep and goats 300 heads; d. pigs 100 heads; e. other species 100 heads; f. eggs laying chickens 2000 heads; g. meat chickens 5.000 heads; h. other species 1.000 heads; i. beekeeping 50 families;

C. For the fishing sector: a. piscine for fishing nursery 10 ha; b. piscine for consume fishing 20 ha; c. trout basins 1 ha.

<sup>5</sup> Review *Gestiunea și contabilitatea firmei nr. 7/2005*, Printing House Tribuna Economică, Bucharest, 2005, p. 63.

- Financial-accounting forms, common in economy, with special regime in printing, writing and numbering: invoice, bill of lading, store-sheets, monetary, payments bordereau extract.

- Registers and financial-accounting forms, commons in economy: encasing and payments register; inventory register; fixed assets list; consumption bon; storage-sheet; inventory-sheet; foreign currencies bills; treasury register (for foreign currencies); acquisitions bordereau; salaries sheet; register for different operations; different operations journal; cumulative document.

From the documents remanded before, encasing and payments register presents a major importance for the single-entry accounting, because it is used as a document for: recording the cash payments and encasings, as well as through bank account; establishing the financial situation of the contributor; prove in law suits. It is realized in a single exemplar and it is recorded and signed by the territorial fiscal organ.

In the specialty literature, the single-entry accountancy for the familial agricultural exploitations supposes the existence of the following elements<sup>6</sup>:

- “Production expenses” sheet in which are recorded the expenses realized, as well as the obtained production for the agricultural cultures, cultures categories, animals categories or for the industrial products resulted from the agricultural goods processing;

- “Treasury” sheet in which are recorded the payments and encasings in cash or through banking transfer;

- “Debits” sheet in which are recorded the debtors of the familial agricultural exploitation;

- “Liabilities” sheet in which are recorded the obligations of the agricultural exploitation reported to different suppliers;

- “Exploitation inventory” sheet in which are recorded the inventoried assets, as well as the total amount of the obligations;

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<sup>6</sup> *Ibidem.*

- “Results” synthetic accounting sheet in which are presented the *gross merges* partially on cultures, cultures categories, animal’s categories, industrial products and others.

Single-entry accountancy in the familial agricultural exploitations framework *should be realized* by using the accounts from the 8<sup>th</sup> class “Special accounts”. With the help of the accounts from the 8<sup>th</sup> class pointing out the assets and contingents liabilities that are represented by the following elements:

- Given engagements;
- Received engagements;
- Other extra-patrimonial elements (Corporal immobilizations rented, debtors set off from the active of the enterprise, but continuing to be followed and others).

*Contingent Asset*<sup>7</sup> represents a possible asset that appears as a consequence of the anterior events of which existence will be supported only through the appearance or non-appearance of some future uncertain events, which can not be entirely controlled by the agricultural exploitation<sup>8</sup>.

*Contingent Liability* is a possible liability, appeared as a result of passed events and which’s existence or non-existence will be confirmed only by the appearance or non-appearance of one or more future uncertain events, which can not be entirely controlled by the agricultural exploitation<sup>9</sup>.

If we made a comparative study between the concepts of “asset – contingent asset”, respectively “liability – contingent liability” we can find discrepancies between the agricultural exploitation control regarding the resources that are available.

8<sup>th</sup> Class “Special accounts” has the following structure (according to Public Finances Ministry Order nr. 1752/2005): 80. ACCOUNTS OUTSIDE OF THE BALANCE SHEET: 801. Given engagements, 8011. Endorsements and given

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<sup>7</sup> The concept of “contingent” has the following significance: which can or can not to be, to happen or not to happen; accidentally. Romanian Academy, Institute of Linguistics “Iorgu Iordan”, *Dicționarul explicativ al limbii române*, Univers Encyclopaedic Printing House, Bucharest, 1998, p. 218.

<sup>8</sup> Public Finances Ministry, *Ghid practice de aplicare a Standardelor Internaționale de Contabilitate*, Economică Printing House, Bucharest, 2001, p. 233.

<sup>9</sup> *Ibidem*.

guarantees, 8018. Other given engagements, 802. Received engagements, 8021. Endorsements and given guarantees, 8028. Other given engagements, 803. Other accounts outside of the balance sheet, 8031. Rented corporal immobilizations, 8032. Received material values for processing or repairs, 8033. Received material values for keeping or in custody, 8034. Debtors set off from the assets, continuing to be follow, 8035. Stocks of inventory objects nature given in use, 8036. Administrating locations, rents, and other assimilated liabilities, 8037. Discounted effects inside of the lifetime, 8038. Other values outside of the balance sheet, 804. Amortized corresponding to the level of non-using the fixed assets, 8045. Amortized corresponding to the level of non-using the fixed assets, 805. Interests rate corresponding to the leasing contracts and other assimilated contracts, inside of the lifetime, 8051. Payment interest rate, 8052. Encasing interest rate.

In the 8<sup>th</sup> class (according to the Public Finances Ministry order nr. 1752/2005), compared to the 8<sup>th</sup> class Public Finances Ministry order nr. 94/2001, we are finding that it was introduced the account 805 “Interest rate for the leasing contracts and other assimilated contracts, inside of the lifetime”, which is functioning through two analytic accounts.

A discussible aspect is the one referring to the contingent assets, which we consider that is represented by the stocks and the inventory objects nature<sup>10</sup>. The Romanian normalizing factor has introduced in the 8<sup>th</sup> class the account 8035 “Stocks of inventory objects given in use”. We consider that this account does not reflect a contingent asset because we are not in the situation of a possible asset, but of an asset, which is already recognized in the accountancy of the agricultural exploitations. This account already contains the records regarding the inventory objects stocks passed on expenses and which’s nature needs the extra balance-sheet following<sup>11</sup>.

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<sup>10</sup> We precise that the material like inventory objects have a big part in the circulate assets of the agricultural exploitations (scissors for different activities and others). If we attempt to the international settlements, this category of the inventory objects is inexistence because we operate mostly with the corporal immobilisations.

<sup>11</sup> Atanasiu Pop, *Contabilitatea financiară românească armonizată cu directivele europene, standardele internaționale de contabilitate*, Printing House Intelcredo, Deva, 2002, p. 1008.

In practical activity of the single-entry accountancy is not given the appropriate importance and is organizing and leading double-entry accountancy<sup>12</sup>. Can we talk about an “impossible coexistence” of the two accountancies in the practical activity? Surely because the single-entry accountancy can offer information that the double-entry accountancy can not assure. If we consider a debtor set off from the asset of an agricultural exploitation, double-entry accountancy can not offer information, but the single-entry accountancy, *if it is organized and lead*, supplies information regarding a contingent asset that can transform into a contingent asset that could transform into a fixed or circulated asset by recording the debt into the account 8034 “Debtors set off from the asset, but continuing to be followed”, for example. This is a good example through which the practicing specialists have to focus on single-entry accountancy. We do not questioning the pertinent information supplied by the double-entry accountancy, but we consider that the two accountancies should be organized together at the enterprise’s level generally, and at the level of an agricultural exploitation, and particularly assuring the reciprocal completion.

Concluding we can say that the dispute between double entry and single-entry accountancy is “almost” won entirely by the double-entry accountancy, especially because it represents the vertebral spine in constituting the accounting information. If we are regarding on long term, we hope that the agricultural exploitations will become in Romania veridical ranches resembling to the European and American models, between which it exists a symbiosis between the single-entry and double-entry accountancy leading to the increase of the efficiency and a better propagation of the information towards different users.

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<sup>12</sup> The accounting theory often makes references to the single-entry accountancy. In this case the professional accountants and praticiens have to consider also the information supplied by the single-entry and not only of the double-entry accountancy.



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# **ROMANIAN PENSION SYSTEM IN THE NEED OF CONVERGING TO SIMILAR EUROPEAN SYSTEMS**

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*Internationalizing represents the process that determines the imminent need of the social policies' convergence at the European Union level, considering the situation in which the interventionism in the member countries' allowances systems is heterogeneous. Developing the allowances system represents a priority for Romania (and not only) as a candidate country for European Union adhering process, where most of the countries are pleading for the need of reforming the national allowances systems and projecting a structure meant to assure financial sustainability on long run.*

## **Rising and declining in the respect of different pension systems**

Globalization and deepening the economical integration determines the imperativity of social policies armonization at the European Union level. European expanding towards East stands as the most important challenge, being the only valid option in expanding the prosperous economical area, social security and political ballance, while interfeering in the pension policy of the member countries is heterogenous.

The imperative condition in Romania's joining to European Union process is ensuring a high level of social security. Although the popularity and the effective importance of social programmes went as the basis of national executives, the deepening of the joining will have second results. Unlike the North American and Japanese models of pension systems, those in European countries characterise themselves by a high protection level and the wholeness of the services. The model of social pensions system founded by Otto von Bismark in Germany at the end of XIX century turned out to be the base for modernization of European human society, especially contributing to the adapting of economy to the fluctuations of the social needs. Interdependence raising between national economies diminish the capacity of the national states to maintain the principles of solidarity and wholeness in the respect of pension systems.

The largest part of pension systems dimension is based upon the principle of repartisation and needs an intergenerational and intrasystemical dimension. The key-examples are public systems of retirement in Belgium, France, Germany and also Dutch and British.

Public systems of pension schemes has risen rapidly in importance in the last century, coming as a result of the high generosity and continuously expanding . reaching its point when covering almost totally the ageing population (In the European Union it represents the most important source of income for old people, covering almost 90%<sup>1</sup> of after-pensioning resources).

The reasons for raising the importance of redistributive system of pension PAYG<sup>2</sup> include the political attraction due to the low cost, especially in the context of increasing population number and the independence towards long term contracts which exist in the private system of pensions. Such contracts have been invalidated countless times from the economical point of view and so, the public contracts sustaining the PAYG systems, seem to be more durable.

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<sup>1</sup> Rother P., Catenaro M., Schwab G., *Ageing and Pensions in the Euro Area Survey and Projection Results*, Social Protection Discussion Paper, no 0307, 2003, p. 3.

<sup>2</sup> pay-as-you-go

Between the '50s-'70s there was a high point in developing pension systems in European countries but not uniformly, dividing into models as follows: Scandinavian (Norway, Sweden, Denmark, Finland) Anglo-Saxon (Great Britain), German (Germany, Austria) și Latin (Spain, Greece, Portugal, Italy).

Summing characteristics of the Scandinavian way refers to high and low universality and institutionalization. Specific for the Anglo-Saxon model, less supplier of social benefits and more „last resort compensatory” due to the social prestatation focusing on those „who deserves” them and encouraging people with high income to fill in the private schemes of insurance. As for the German model, there is a high level of taxes for balancing the salaries and incomes, together with the existence of some problems in financing the pension funds. The Latin model is rudimentary and stresses the solutions regarding civil society (church, family, charity), so the system is more selective than universal, leading to a high level of poverty and social exclusion.

Starting onto the seventh decade of the twentieth century marks the starting of a decline respective to pension systems. Oscillation of the population number stands as an explication for the high number of pensionaries. The greatest part of the expenses being financed through the contributions to the paid social insurances from the salaries, the modification of the variable working market pays an important role over the stability of the pension system, participation of the working force being relatively constant in the European Union in the last decades at a rate of almost 67% - 68%, while the hirings has risen at an annual rate of only 0,5%.

The danger of unsustainability underlined the necessity of a „social intervention” at the community level, required mostly during the '90s, when the social problems deepened. The aging population forces the public pension systems to imminent future reforms.

As a result of the actual oldness of the public retirement schemes and since the second world war, the first generations took advantages of the so called „breakfast on the house” of the allocations relatively generous with little contribution. Nowadays, it

is important to realise the overleap of the starting period and entering into the „relative maturity” stage, according to the non-validity of the public schemes.

Taking into consideration the demographic changes, a public system of pensions which overleapped the starting phase has no more than two ways to go in order to ensure the viability together with the implication of a high degree of reforming. The first solution is the consolidation of the financial resources through the rising of the contribution tax, rising of productivity and so of the salaries, implication of the working force, identification of some great transferrers of thr general budget. Secondly, the strategy of dimunuishing the expenses should apply through the prolonging of the minimal age for retirement and also lowering the rates of the services offered by the system.

The two ways of reforming follows the same objective, meaning a resonable dimension for the relative level of the allocatins/services reported to the contributions, facts that lead to insuficiency and lack of perennal perspective for any variable in the systemic combination, no matter the adaptability to the existential context.

Heterogenity of the social national policies respective to pension ensurances is also confirmed through the significant variations of the expenses with the public pensions on the PIB. The planned evolution of the public schemes expenses in some member countries of the Organization for Cooperation and Economical Development (OCED), without modifying the present parametres, has ,with only one exception, a unique sense, rising, according to the following table:

**Planning the evolution of the expenses in the public pensions’ schemes**

*(% of PIB)*

*- table no. 1 -*

Year Country	2010	2020	2030	2040	2050
Germany	11,8	12,3	16,5	18,4	17,5
Canada	5,3	6,9	9,0	9,1	8,7
France	9,7	11,8	13,5	14,3	14,4
Italy	13,2	15,3	20,3	21,4	20,3

Japan	19,6	12,4	13,4	14,9	16,5
Holland	6,1	8,4	11,2	12,1	11,4
United Kingdom	5,2	5,1	5,5	5,0	4,1
USA	4,5	5,2	6,6	7,1	7,0

Source: Alain Jousten, *Départ a la retraite: une perspective internationale*, *Problème économique*, janvier 2004, p. 2.

As it can be seen, in Italy, the public pensions are going to cover soon over 15% of the internal annual product and in Japan, almost 20% soon. In 2004, according to Commertzbank<sup>3</sup>, a German bank, the paying obligations of some governments respective to pensions will be three times higher than the internal product of their country, unless the necessary is done.

The perspective over the state pensions is not as bad in all European countries. Great Britain, Holland, Scandinavia and Switzerland for example have already passed a great part of their responsibility from the first pillar (state) to the second (the employer) and in some cases to the third pillar (the future pensioner)

Although in ascension regarding the importance according to the Trait of Amsterdam in 1997, the European social policy seems to be on a second place respective to taking decisions, conferring freedom to the member states in implementing their own ways in pensions ensuring.

### **European principles and action directions for proper solutions in balancing and ensuring the financial support on long term respective to national systems of pensions**

At the beginning, the European Union social policy was taken as complementary and subordinated to the economical objectives. Joining to the European Union with its oscillating influence of political into the social, will have to determine the converging of the pensions systems to a minimal common level and validity. Theoretically argumentation of the converging, as a joining principle, results from the classical and neoclassical approachings regarding the free exchange and the

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<sup>3</sup> Special report: *State pensions in Europe. The crumbling pillars of old age*, The Economist, September 2003, p. 71.

theory of customing unions by Viner in 1950, who points out the advantages of regional joining in the case of comparable levels of development countries and structures which can generate, through restructuration, organic complementarities.

Analising the similarities and differences between the systems of pensions of the members countries of the European Union, led to the possibility of every state to keep its own system, the beneficiaries rights being enlarged in the Common Market.

Most of the member states offer pensions schemes based on work market. In the private field these usually represent PAYG systems, which, in some cases, are partially financed by the state budget (in Belgium, Germany, Greece, Spain, France, Italy, Luxembourg, Austrich și Portugal). Such schemes are usually concerning the earnings but they can offer to all the pensioners an identical pension (this system characterizes especially the countries with developed schemes from the second pillar such as Ireland and Holland ). In three countries Belgium, Germany and Greece, pension system for public pensioners is financed only by the state budget, while in Ireland the scheme for the public sector is entirely PAYG. The remaining countries are characterized by a pension regime partially PAYG and partially financed by the state budgets. The schemes in the second pillar are rarely obligatory in the private or public sector, while the individual volunteer plans are generally insignificant.

Coordination of the social security systems stands under the law at the European level, Through the Rule 1408/71 respective to coordinating the systems of social security for working persons, for independent workers and members of their families who travel in the European Community and Rule 574/72 respective to the Implementing procedures of the first rule. The principles instituted through the communitary papers refers to the payment of the social contribution in a single member state, equality between the travellers and the citizens of the respective state, maintaining the right of pension through the reglementation of the transfeer of the service done between the member states, together with summing up the ensurance periods which certifies the right of pension after a minimum stage of installments. European Commitee's objectives focus on the complementarity of the working force

to the retirement policy, promoting the concept of active ageing and expanding the impact of such an abordation over the young generation.

In the moment of joining, Romania will have to fall under the provisions of the Union respective to transferring the benefits of pension, public or private: (a) interdiction respective to contributing simultaneous to two national systems for the same kind of pension; (b) giving the pension to the employees or their descendents in case they live in one of the European Union states; (c) rezidence out of the country which supplies the benefit leads to atributing a pro-rata kind of pension; (d) the amount of the pension is set according to the contribution period; (e) contribution to the pension system of the persons who are not resident of that country impose them the same regulations referring to a contribution period, but, unfullfilling the period can be completed by a period of activity in another state, which is set by the supplying state of the pension benefits.

The European code of social security also sets the conditions of functioning for the pension systems in the member states such as: (a) the retirement age doesn't have to be more than 65 years (older age can be set in case the residents of this age is bigger than 10% of the rezidents' number under that age but over 15 years); (b) medium period of cotization of 30 years; (c) replacing through pension of at least 40% of the previous income during the active period; (d) possibility to work over the retirement age.

According the strategy in Lisbone<sup>4</sup> the European Council addopted in 2000 some rules to lead to solving the differences and ensurring the support of pension systems (supplying pensions which lead to a decent standard of living for pensioneers, promoting the solidarity between generations, possibility of acces to the public or private systems of pensions and modernization of pension systems to supply the needs of the working class).

Estimations refferring to financial susteinability for public systems of pensions target on raising the rate of working force, generally of the population of 55-65 years old, especially (from 38,5% until 2010), attracting the qualified working force from

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<sup>4</sup> www.eu.int.org, *Adequate and sustainable pensions*, Lisabona, 2000.



the developing countries, encouraging the women to work again, equalization of the retirement age between men and women to 65 years till 2020. Economical development, an important aspect in underlining this objective will lead to an employment rate of 70% of the population in 2010 and 83% in 2045; one year prolonging of the retirement age will determine the absorption of about 20% of the expenses in 2050 together with greater benefits for pensioners. Lowering the pressure onto the public system through the access to additional pensions, identification of other sources in sustaining these ones together with constituting the reserve funds to face the retirement of the baby-booms generations constitutes directions of action which answer to the insurance needs of the financial support of the pension systems.

Sweden is the country which, through the coming back with 18% of the employing over 55 years, created a Swedish model regarding pensions insurance, capable to face the retirement wave. Flexibility of retirement age is another element of the Swedish scheme. So, a lower pension can be obtained starting with 61 years old and its amount rises together with retirement age and to the life hope of the workers. There is also a difference respective to the working time of the ageing people according to their work capacity, respective 25%, 50% or 75% of the normal working time. It is also added a serious control of the sickness indemnizations in the purpose of lowering the fraud and waste.

### **Romanian system of pensions, conclusions**

Romania's joining to the European Union implies changing the internal legislation following a pack of communitare norms which reglements the improving of the working and life conditions, known as „acquis comunitar” completed with a serie of principles, directiveness lines, commune objectives, elements which formes the so called „soft acquis”<sup>5</sup>. Romania engaged itself to integrate the internal

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<sup>5</sup> Studiul nr.10, *Măsurile care trebuie întreprinse pentru asigurarea compatibilității între sistemele de asigurări sociale din Uniunea Europeană și România*, p. 4, [www.cpisc.ro/files/dosare/studiul10.pdf](http://www.cpisc.ro/files/dosare/studiul10.pdf).

legislation regarding social policy to the norms and standards in february 2000, when it started joining negotiations, position document respective to chapter 13 of the *acquis comunitar*, meaning „The Social Policy and working force” handed officially to the European Comitee in May 2001, negotiations taking part at the end of the same year.

Fullfilling this wish marks as imperative the solutioning of the existing problems within the Romanian system of pensions, identified by the European Comitee in the periodically report in 1997, respective to the „progresses” made which refers to the following aspects<sup>6</sup>: lower rate of collecting the contributions<sup>7</sup>(which determine the financial crisis of the system exclusively based on pillar I) supplying a low rate of PIB for such expenses<sup>8</sup>, differences regarding the pensions in the system. These aspects question the capacity of the actual pension system to implement the European rules and to face the coordination of the social ensurances systems of the Union.

The statute of the pension system is presented with the same coordination in the report in 1999. Law 19/2000 respective to the public system of pensions and other social ensurance rights allows the partial transfeer of the rights and benefits gathered in the states in which Romania has signed agreements in this respect but the need of strengthening the administrative capacity is underlined in managing the system. Coordinating the pension system with the ones in other countries implies developing some appropriate administrative structures and proper training of staff, the report in 2001 underlining the need of getting on the negotiations for mutual agreements respective to the benefits export. Administration’s role in any type of reform is essential, administrative performance constituing one of the key elements for the succes of the reform in the pension system. The absence of an European model for the option of the reform in the pension system makes organizing and functioning of the administration of pension funds to belong to each state, having the task of

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<sup>6</sup> Preda Marian ș.c., *Sistemul de asigurări de pensii în România în perioada de tranziție: probleme majore și soluții*, Institutul European din România, 2004, p. 9.

<sup>7</sup> In the year 2001 - 77%.

<sup>8</sup> In România expences public represent approximated 7,1% –7,2% of GDP.

ensuring a functional coordination between the specialized administrations in the member states.

Developing a proper institutionalized background and some functional administrative actings comes as a need for Romanian institutions, the institutional aquis represented by norms, acts, metodoloies being very important for a successfull joining. The designed institution to intermediate contracts respective to beneficies transfer is The Ministry of Social Solidarity and Family. After the joining, the rules of coordination will be functional stated by Rule 1408/71, aspect which implies special rules respective to pension prestation services and their payment to any person who worked somehow on the teritory of many member states.

Opposite to the situation in the member countries of the European Union, in Romania there is a high level of contribution for financing the pension funds, imposed to the companies, fact that leads to the not-payment risk, while the relatively low level of the employees diminishes the possibility that a part of this to be transferred to pension funds based on capital affluence.

Modernization in the pension system constitues a priority for Romania (and not only) as an applicant to the joining into the European Union, where most of the states pleads for the need of reforming the national systems of pensions and designing a structure which has to ensure long term financial sustainability.

Guaranteeing safe and durable pensions is conditioned by <sup>9</sup>: ensuring a decent level of life which to ellude poverty and social marginalization, identifying alternative sources for financing and stabilization of the expenses regarding pensions to prevent the financial pressure generated by elderring population, the capacity to adapt the pension systems to society's changes coming from flexibilization of work, growing the number of women on the working market etc.

The influence of Mondial Bank and of the models in pension systems it promotes and the need of assuming European requirements, impose a working method which substitutes the exclusive legislating at national level of the pension ensurances on the basis of subsidiarity principle. The liberal model of the pension

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<sup>9</sup> Comunicarea Comisiei Europene, *Dezvoltarea strategiilor naționale pentru COM* (2001) 362 final.

system with three pillars is to be found especially in the Central and Eastern Europe countries. In the process of „systemic convergence” respective to pension insurance it is necessary taking into consideration of the level of deficits known by the state social insurances, of the managing and financing way of the transition from a redistributive system to a multipillar one, settling of the collecting contributions apparatus structure and ensuring transparency through plainness and stability of the law system.

Among the internal problems to be solved there are those concerning some private institutions focused on social policies respective to pensions and encouraging the transfer of a part of responsibility for a decent income towards the individual and the community he lives in (non-governmental organizations, churches). The simple adoption of the European standards doesn't lead to a successful reform.

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# **SOCIAL HEALTH INSURANCE REFORM'S IN VIEW OF ROMANIAN'S INTEGRATION IN THE EUROPEAN UNION**

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*The sub-financing of the system of health insurance, having complex and diversified causes, but a common root has determined the authorities to propose a reform in health. A solution to solve the problems of the social health system of insurance is represented by the complementary volunteer insurance or the health supplementary can cover individual risks in special situations and/or together with the services covered by the social health insurances. At the same time, the state authorities have identified the reform of the hospital sector as a priority.*

Health care represents in Romania, as all over the world, not only a problem of medical assistance, but also an economical-social problem of great importance for the entire mankind, concentrating important financial resources.

Social health insurance systems are among the most complex in Europe, making them complicated to describe and difficult to evaluate. Actual funding, allocating and delivery arrangements in place in western Europe social health insurance systems countries have undergone considerable change during the past decade and additional reforms continue to be under serious consideration for the near future. Despite a long and distinguished tradition, social health insurance systems arrangements in Western Europe have come under increased pressure over the past ten years. Confronted by

intensified clinical, financial and social expectations, policymakers in these countries have begun to re-examine the efficiency, quality and responsiveness to patients of their health systems. Further, there has been growing interest in measuring health system performance in terms of outcomes, particularly regarding its contribution to overall health gain in the population.

In the countries of European Union, once with rising in health expenses (generated by many factors such as: the aging of population, accentuation of risk factors and new diseases, raising in costs for medical services so on so), the question of performing new reforms within the health system has become a task. Such health system takes into consideration, in the first place, the improving in quality for the medical services and ensuring enhanced financial resources in order to cover expenses in the health area. Thus, in Germany authorities have introduced a private unit of health insurances and in France the income limit for which due at health insurance is to be paid has been eliminated.

Romania used to spend for health between 3-4% of GDP. This was one of the lowest shares of GDP devoted to health among Central and Eastern Europe Countries – even if, according to the World Bank, consistent with the development level of the country. While most European states spend around 9-10% of GDP for health and even the other Central and Eastern Europe Countries spend over 6% of GDP, global health expenditure in Romania reaches only 4% of GDP. It is conceivable that the concern for social rights at the European level will translate in pressure to increase public expenditure on health. The health status of the Romanian population also looked worse than in neighbouring countries. In this context, policy makers considered the level of spending insufficient, and the social insurance was introduced to mitigate this situation.

In our country, the sub-financing of the system of health insurance, having complex and diversified causes, but a common root – the weak development of national economy – has determined the authorities to propose a reform in health, starting with an improvement in the management of expenses for health and with enhancing financial

resources. There are two major institutional design problems affecting the Romanian health system. The first concerns the non-competitive nature of the health funds, which are regional monopolies, further restricted by national regulation. This results in a lack of incentives for regional funds behaving like selective purchasers. The second unresolved matter is the division of labour between the system of health funds and the government. The lack of competition between health funds creates an institutional set-up where there is no incentive for the health fund to take on these powerful interest groups and enforce hard budget constraints upon hospitals. The dominant strategy is an alliance of the purchaser with the provider to pass the costs to the budget. The autonomy of hospital managers is limited, what precludes even the restructuring measures intended by the public-spirited managers.

Despite the efforts done by the executive in order to ensure all necessary financial resources for a good functioning, in normal limits, of the social and health insurance system, the problem of financing, securing and the distribution of medicines and medical materials has been aggravating. Nowadays, because the amplification of financial blockings and because of the hospitals' raising in debts to medicines suppliers, some medical units have come to temporarily stop their activity and this had disastrous results for the present and future patients.

Compensating of price for the medicines used by patients with small incomes and by pensioners has become a problem more and more difficult to be solved. The situation has become critical for patients suffering with diabetes who wait for days in front of drug stores in order to receive compensated prescriptions.

Not paying in due time to economical agents of health insurance contributions has also become a health financing problem added to the dysfunctional actual system.

The priority measures that should be taken for a reform in social and health insurance within the Romanian medical system refer to the following aspects:



- to guarantee the access without discrimination to medical basic care, no matter the income. The right of population to freely choose health care should be emphasized and this option should not be imposed by the state;
- stimulating privatization for the infrastructure of medical units except the facilities which, because of the high level of needed investments, could not be sustained by private operators or by local authorities, excepting as well those which have strategic importance for the health of the population;
- the entire activity in the sanitary area should be based on both contracts between the insured and the houses of insurance and also between the latter and the suppliers. The frame contract of supplying sanitary services within the social system of insurance will be negotiated with all the representative organizations of such service suppliers at local level. Action should be taken against discrimination and inequalities and equal rules should be established for free competition in sanitary area. The sanitary system will be based on the principle of free competition between suppliers for the existent funds and the state should respect the neutrality for all suppliers of medical care. It is necessary to introduce means of payment to reflect the individual activity of each supplier of medical services within the system;
- improving the financing of sanitary system by allocating with priority resources gained as a result of economical development, by reallocating budgets within the system as well as by eliminating those expenses outside the sanitary system. The sources taken into consideration for supplementing expenses for health in accordance with the real needs of population are: paying from the budget for the expenses of the medical-social units and also for work accidents, expanding the basis of taxes (by reimplementing taxes for health insurance for all those who make profits and by stopping to allow to certain economical agents exemptions from health insurance contributions), creating new jobs, obligativity for the people working abroad to contribute to the health fund, stopping work on the

- black market, introducing private health insurance, involving local communities in financing medical actions, enhancing finance from state budget;
- paying in full all the budgetary debts to suppliers in order to be able to introduce the principle of respecting of contracts. The entire cost of the essential medicines for health care will be covered from the social insurance fund, each patient paying only a fix minimal contribution for each prescription. Transparency should be introduced in using funds for compensated and free medicines in ambulatory, by allocating a proper amount for such expenses, for each doctor, following the principle "money follows the patient";
  - diminishing excessive bureaucracy, which makes the access of population to free and compensated medicines slower and the activity of medical services and pharmaceutical suppliers, as well as decision, based decentralization. For this purpose, legal mechanisms will be created so that, together with a proper financing of sanitary hospital units, the local authorities can make decisions for the health care of the population in the area. Thus, the state will diminish its influences upon the sanitary system concentrating on the major public health problems and on protecting and respecting the patients' rights;
  - establishing a set of basing medical services to serve all those who pay taxation within the social health insurance system and the obligativity of medical units to presents to patients, at their releasing from hospital, an estimate with all the expenses both paid from the budget of the health insurance and the ones fully paid by the patient. This will allow a better control of the activity and of the financial management from sanitary institutions and also a more transparent use of public money;
  - introducing the European and the National Card of social health insurance. The European Card gives the right of medical care to the insured, necessary during his temporary residence in a state, member of European Union. In our country, health

insurance houses are compelled to recognize as valid the cards issued in states, members of European Union.

A solution to solve the problems of the social health system of insurance is represented by the complementary volunteer insurance or the health supplementary can cover individual risks in special situations and/or together with the services covered by the social health insurances. Volunteer health insurance doesn't exclude the obligation to pay the taxation for the social health insurance.

According to law no. 212 from May 27<sup>th</sup> 2004 concerning private health insurances, an optional system is set up for paying medical services, additional to the obligatory system of health insurance, from which supplementary sets of services will be financed, besides the basic set of services, covered by social health insurances, in accordance with the laws in force.

Private health insurances can be:

- complementary private health insurances (they totally or partially cover payment of services, partially excluded from the basic set by the social health insurances, including co-payments, depending on each situation);
- supplementary private health insurances (totally or partially cover payment for services exceeding basic set from the high degree of comfort, rapid access to medical services for the waiting lists, special medical services abroad or other services);
- substitute private health insurances (totally or partially cover payment for any type of services).

In the private health insurance system, insured are considered to be those individuals who have a private insurance contract signed with an insurer, individually or by a third party. Employers, individuals or legal entities can sign private health insurance contracts for their employees, individually or in group, given as additional benefits to wages with the purpose of attracting them, making a selection or to stabilize the already hired personnel.

The necessity for an optional system of health insurance in Romania is imperative, taking into consideration both the strong financial pressures that the public social insurance system makes upon state budget, and also the diminished quality of the medical services offered by it. Nowadays, the member of persons taking benefits of private health besides wages, offer incentives to their employees in the form of private health insurance policies or the insurance companies offer attractive sets of included life insurances and private health insurance policies.

Thus, the client pays the premiums for the life insurance but the company assumes the responsibility to give back to the insured a certain amount, established in the contract, in the case of incapacity to work because of illness.

On a medium and long term, private health insurances have a great potential of development. Taking into consideration the signals coming from the market, they become more and more attractive for the great companies on the insurance market. Omniasig, Aviva, Interamerican, Allianz-Țiriac are only few from the companies activating on the market of health insurance.

The methodological norms for applying the law of private health insurance mention the fact that the access to the private health insurance has, as a condition, the quality of the social health insured. Thus, people who do not pay in due time their taxation to the state social insurance or who are not recorded to a family doctor will not be able to sign a contract for a private health insurance.

Because insurance companies are compelled to verify if the individual or the legal entity pays the health insurance contributions and if it does not have debts to the National Fund of Social Health Insurance, it is considered that this provision determines the raising in costs in the case of signing a policy of private insurance.

The option of the Romanian government for the private insurance system totally modifies the structures of financing and functioning, imposing a new way of organizing the supply and the payment for medical services. The system of private insurance, characterized by a view based on individual insured is financed through individual

contributions (sometimes for employers) and by giving medical services in a private system. In this system, patients and medical assistance suppliers sign individual contracts referring to the type, volume and the price of medical services. The set of services is limited being supported by the individuals or legal entities' taxations, depending on the risk. The private health insurance is offered by the insurance companies and it can be individually subscribed or for a group of individuals. If it is individually subscribed, then, the insurance company takes into consideration the characteristics of the individual: age, sex, state of health. If the health insurance is subscribed for a group of individuals, the insurance company takes into consideration those characteristics of the group, considering the risk, as well as the dimension of the group, its average age and other things.

Law no. 212 from May 27<sup>th</sup> 2004 concerning private health insurances regulates the set up, the authorizing and the functioning of private societies of health insurance as well as the suppliers and the beneficiaries of this system. Thus, according to article 4 of this law, there are considered to be eligible for the services offered by the private health system of insurance, all individuals, Romanian citizens, foreign or stateless citizens with the domicile or residence, according to each case, within Romanian territory, who, after having fulfilled the obligatory requirements of the social health insurance, sign contracts with private health insurance companies, further on named insurers and after paying the insurance premium. The citizens of the states, members of European Union, as well as citizens of the states with which Romania signed agreements, conventions or international protocols of cooperation in the health area and medical sciences are eligible for the services offered by the private health insurance system and without the necessity to fulfill the obligatory requirements of the social health insurance, if those agreements, conventions or protocols signed between Romania and the respective country do not specify as such.

Through the contract of private health insurance, the insured is compelled to pay to the insurer certain private health insurance premium and the latter, in his turn is

compelled that in the case of a risk assumed in contract he pays, in the name of the insured, the type of medical services, depending on the quantity and quality of the medical act also on the individual risk, or other services received from the suppliers of medical services, within the limits and terms established, as well as the additional expenses in the case of such services.

The monthly premiums for a private health insurance vary between 10 and 70 Euros depending on the state of health, age and sex of the person who wants to be insured. Private health insurance companies ask the petitioners to have a medical check before signing the policy. The private health insurance policies are attractive enough, taking into consideration that in private hospitals or clinics the cost of day can reach 100 Euros.

Ever since the first years of transition to a market economy the budget allocated to social health insurances, in our country, has been insufficient, based on not transparent criteria because of financial compulsion. In its present state, the system of social health insurances is characterized by deficiencies and the lack of transparency in the manner of spending the available resources, determining the budget of sanitary institutions to be established not depending on accomplished index that will allow raising amounts properly for the activity, but within the limitations of a small budget.

The non-competitive nature of the Romanian social health insurance funds is always going to create incentives problems. They can be however partly mitigated by:

- clarifying the ownership of hospitals, by transferring them to the local government, or better by establishing them as independent charities;
- creating the incentive for managers to allocate efficient all expenses, by funding capital and operational expenses according to the same mechanism;
- devising incentive plans for hospitals managers that reward good performance.

The sustainability of the Romanian healthcare system requires first of all adequate budget control mechanisms at the hospital level. The hospital profligacy sucks in resources destined for primary care and medicines consumption. The incentive

misalignment that results in the current serious funding crisis has been analysed in the healthcare background section. A second type of concerns for the sustainability of the healthcare system springs from its ill-conceived institutional structure, as presented above.

The reform of sanitary system, initiated a years before the long waited integration of Romania in European Union, should determine, on a medium term, complex effects among which the possibility of insured to beneficiate of quality medical services similar to the ones in western European countries.

One of the most important changes included in the reform project is represented by a basic unit of medical services ensured by the social health insurance system and the rest of the medical services should be covered by the private system. Nowadays, the minimum set of services covers 97% but money is not enough because the real public system covers these expenses at the upper limit of the existent budget.

That is why here are attempts to create a mixture system made up in majority by the health private system. The disadvantage for the ones interested in the new optional system is that they also have to pay the taxation of 6,5% to the social health insurance, the companies in the area being able to sign health insurance contracts only with the persons who fully paid social insurances offered by the state.

A modality to enhance the interest for the health complementary system would be to reduce social taxations both for the employee and the employers. The reduction does not necessarily mean a drop, but an option of the employee who can pay the difference to a private operator or to the National House of Health Insurance (for example a reduction from 6,5% to 6%).

Legislative regulations within the area of health insurances have not succeeded to answer all the problems. However, many specialists are concerned about health being presented as an economic factor the grounds that this may had to basing principles such as equity, ethical issues and health as a human right being underemphasized. They support positioning health as a driver of economic growth by showing the benefits to

public finances and the economy of pro-actively promoting health and preventing illness.

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## THE BANKING DISTRICT IN ROMANIA

**Ec. drd. LUPULESCU Grigore**

*We can talk about a truly banking sector in Romania after 1990 (without neglecting the years before 1948).*

*After 1990 the banks had to face instability financial factors from outside the borders, in a time of general instability generated by the transition process. Transition for the Romanian banks started by changing the law and their statut. Now the banks have the freedom of choosing the parteners - Romanian or foreigners, but they had to face competition – other financial institution (mutual funds) and other banks (Romanian and foreigners). The National Bank started a direct refinance of the banks to change the prudential rules, but the financial situation of the traditional big companies got worst.*

*In the year of 1990 the romanian banking area was dominated of banks with the register capital from the public area, but at the end of 2004, 30 banks (the existing banks was 32) had a private register capital.*

*Characteristic to our market is the fact that we have a small number of banks comparing to other countries, but the rate of concentration is high.*

*The first five banks had almost 2/3 of the banking market and BCR only has a third of it.*

*In the matter of the origin of the capital, the dynamic was interesting: in 1999 one third of the foreign capital was French, in 2002 the lider was the Austrian capital (40,4%), position kept at the end of 2005 when Erste Bank purchase BCR.*

*From 1990 till now some banks went into bankruptcy (Bankoop, BIR, The Turco-Romanian Bank, Credit Bank, Bancorex who was undertake by BCR). All of this cost the Romanians around 3 bilion dollars, about 10% of the gross national product.*

*The banking area - an essential component of the national economy, reflects through its evolution the stage of the Romanian economy.*

*The “intermediary level” as a ratio between the deposits and nongovernmental loans in the gross national production, is small comparing to our neighbours and really small comparing to the advanced countries.*

*From this point of view, the banking sector has a huge potential in the years that comes, and because our economy improve, the intermediary level will increase.*

*On the Romanian financial market, the network infrastructure (agencies) has to develop, to enlarge.*

*Now statistics shows that for one million people there are 1,8 banks units. For one million people who already has a bank account the coverage is 3,3 banks units, and this is way down the European countries and other advanced countries in the world.*

## **FEATURIES OF THE ROMANIAN BANKING DISTRICT**

About the banking district operation mode from Romania, we must remark the fact that in our country the banking activity did its appearance in the half of XIX century. The National Bank Of Moldova was the first bank made on our territory to 12 March 1857, with center to Iasi and branch to Galati and Bucharest.

In 1880 The Romanian National Bank is taken birth by princely edict like private principals and with the state participation, which gave a new boom to the banking principals increase.

In 45 years of out made to order, the banking were excessive centralized, majority banking functions were complete.

The National Bank, have as much role of the central bank of broadcast, but as of the commercial bank, merely some areas be covered in some banks specialized (Romanian Bank of Extern Commerce- for operations of import of the states, Bank of Invest for financing long-term investments do state, Agricol Bank for support the area of agriculture and food industries, in what weather, House of Economy took over deposits of physical persons the one and of their credits exclusive for the purchase of house from the fund states).

The new politic regime sets up in december 1989 carried and stated strategic option set up the saving of the market in lost a banking system with the National Bank ans have the role and of "arbitrage" and of "speculation".

The setting-up of the market in Romania after 1989 solicits imperatively and the of a organization banking proper system. In this sense through law no. 33/ 1991- Looking the banking activity and law no 34 /1991 - Looking the statute of National Bank, they founded the creation in democratic of a Romania banking system on two ways:

- National Bank as the the central bank with attribution of broadcast, check and supervision, maintain the stability prices;
- The system Commercial banks, carry operate as banks of businesses, generically either specialized. In 1st december 1990 was born the Commercial Bank of Romania by taking over all commercial task from National Bank, being the nucleus systems commercial banks.

The normative which frame regulate the banking activity was modified and completed through banking law no. 58/ 1998 and the statute of National Bank confers it independence in report with others, were modified and completed through law no. 101/ 1998.

In Romania the former wealthy banks must survive all factors of financial international in a unsteadiness context of general unsteadiness generates of the transitional process. Meant for the Romanian banks the stale modification, legal operatic frame, freedom in choice domestic partners the external and competition from other financial institution (the funds of placement) and other Romanian banks, create after 1990 the foreign), reduce refinanace directly of to the central bank, the permanent change targets of BNR and the deterioration financial situations majority big customers.

The biggest problem which confronted the banking market was the financial system.

Financial systems consist in its quick reaction don't except to the economic variables (breed economically, reflation, unemployment etc.), just in elder to

measure, to the politic variables (crises, declaration etc.) and psychological (comments, rumors). The absence opportune decisions the operative and authority of supervision, check and step in toward one disfunction which can appear in the operation financial systems can have, beside the irrational decisions, appeared on the fund absence from creditors and debtors financial institutions, effect among most destructive in economic social even the and in last politic instance.

Result, therefore, as for the financial systems must let us holds the all expense the involved parts:

- tenderers Of funds;
- Inquirer Of funds;
- Overseer;
- Financial manager.

From sin, conversely, than in very little measure directed to the organism with targets of settlement, supervision, check and interfere and no of to politicians, in last instance, directing to the direct subordination against Parliament organism.

These former actors financial phenomena comes back them and the responsibility, after case, but in different degree, creation of problem in the financial system AND, particulary, banking bankruptcies.

But for planting distrust populations in the financial Romanian system, and in the banking system, the responsibility must expanded in certain mode about politic forces.

Former step in submit financial Romanian systems was "Caritas", phenomena, this phenomenon developed disappeared below look but that protectress, against all factors of decision in state (politics and administrative), civil company and mass.

An another phenomenon whereat they have the Romanian petition a date with their attempt reentered in occidental were the creation mutual funds, knowed and below name of funds of investment.

Last "FNI", the phenomenon jolted, near definitive the confidence of populations in the public authority, near the mistrust in authorities, from sin, these

from former contributed decisive the and to loss confidence populations in institution and economic mechanism fundamentally for the natural operation economies of the market (the financial institutions the and respectively, reposal).

Among another characteristic the important maul of banking market from Romania after 1989, I can else can enumerate without pretension of depletes them:

- Be of a big arrear;
- The contiguous process of reorganization economies through: close of a unprofitable enterprises, the of a bankruptcy enterprises;
- Big fluctuation exchangeable currency courses;
- breed massive concomitant imports with diminution exports;
- Breed the unemployments;
- Diminish Pib;
- Diminish the installments of save up in chief populations;
- Deafly capitalize the commercial banks;
- Excessive reflation of big in special in prime year in year out 1989;
- Deafly banking competition. BCR and Cec-ul (becomed the universal bank hardly in 2005) they were always favorit of to state, having monopoly on certain segment of the banking market;
- Hard influence the politic factors about main "actors" from the banking market (BCR, CEC, Agricol Bank and BRD);
- missing banking supervision of Central Bank;
- Reduced degree of informatic services in the banking system. BNR can tax the term of achieves the banks;
- Deafly personal banking quality. After 1989 came in the banking system wage earner without bareback has any quality worked in banks. BNR no heretofore interfered no after the implementation systems of they supervise CAMPL (begin of 2001 year), BNR undertook the firm measures concerning management commercial banks.

The difficulties transitions and they put the mark and on evolution banking

systems from Romania, many from the banks made forward still more selected .After 1989 he obliged his ceasing the activity, saddle restructure, or his he is taked over through fusion of another banks.

Were closed a series of banking companies the big his maul the little maul: Bankcoop, Turkish-Romanian Bank, Credit Bank, Albina Bank, Romanian Bank of Scont, Investment and the Develop Bank etc.), and Romanian Bank Of Extern Commerce, due to grave problems wherewith they were, taked over through fusion of BCR.

The process of taking over banking Romanian systems in this period cost the Romanian state across 3 equivalent milliards USD, respectively 1010 from the domestic gross product.

Some specialists consider only that as the a part from these expenditures could be avoided or at all events attenuate if the banks in question plough be former better driven again the authorities of supervision plough be exercise else rigorous this activity.

In this sense is of absent reflection near total BNR in the process of banking supervision till in the year 1999, when from the banking Romanian came out Bancorex through fusion with BCR follow her entrance in incapacity of the pay, - her bankruptcy be inevitable but that merging.

The year 1999 represents the of a beginning process of taking over and the consolidates the banking sector, ghost a period of stabilizes the performances.

With draw out from the system Bancorex - among the Romanian banks with banking specialists of exception, with a logistics of which BCR no currently he don't disposes, National Bank begins a process of banking supervision the next to maul what plough be musted the saddle does from 1990 here, but don't with a conviction a total, the evidence be the massive which former were in progress in chief in BCR and CEC (banks with state principal in the year 2005 (seen the fraud of 6.000 mld. Lions (ROL) in the folder BCR Novaci, fraud in 2002).

## EVOLUTION OF BANKING DISTRICT IN ROMANIA

The banking system is the topmost segment of financial Romanian systems, his assets is 37,7 % from PIB to god-daughter years 2004 (annual report BNR).

To god-daughter years 2004, were operationally in Romania 39 of banks which structure is presented in the next table:

### Concentration degree of the banking system (first 5 banks)

	1990	1995	2000	2004
BANKS	7	24	33	32
- state principals	5	7	4	2
- private	2	17	29	30
• autohton	2	9	8	7
• foreing	-	8	21	23
Foreing banks	5	7	8	7
Banking system	12	31	41	39

Source: Romanian National Bank

The classification of the banking systems after proprietary form, takes out in obvious growth ab a year to other weight private principals in total bank stock, thus:

### Evolution banking systems after proprietary form

Year	Social Founds			Net assets		
	Total	State founds	Private founds	Total	State founds	Private founds
1998	100	52,1	47,9	100	71,0	29,0
2000	100	38,4	61,6	100	46,1	53,9
2002	100	32,3	67,7	100	42,4	57,6

Source: Romanian National Bank

Therefore, to god-daughter years 2002, merely app. 133 from the social bank stock from the banking Romanian system the maul is the state prisoner Romanian, difference of 23 be extreme private, prevailingly foreigner. Romania, Economy House and Bank of Export-import bonus among they, Romanian Commercial Bank the Romanian banking leader market and the he finished the process of taking over to god-daughter years 2005.

Must recognized the fact as the, on the way taking over, the foreign banks presence in Romania compete strong with the Romanian banks.

Provenance foreign principals in the banking Romanian system, depending on homesickness of origin is presented in the next table.

### Participations foreign principals depending on homesickness of origin

	1999		2000		2001		2002	
	% foreign capital	% banking system capital	% foreign capital	% banking system capital	% foreign capital	% banking system capital	% foreign capital	% banking system capital
Austria	5,4	1,7	7,8	3,2	39,5	21,0	40,4	21,1
South Koreea	2,6	0,8	4,6	1,9	4,0	2,1	1,8	1,0
France	33,0	9,9	16,9	6,8	6,3	3,4	11,6	6,1
Greece	9,6	2,9	20,9	8,5	11,1	6,0	11,8	6,2
Italy	0,5	0,2	0,9	0,4	2,0	1,1	5,0	2,6
United Kindom	2,4	0,7	2,1	0,8	1,5	0,8	1,1	0,6
Monaco	1,7	0,5	2,7	1,1	1,0	0,5	1,3	0,7
Holland	2,9	0,9	7,8	3,1	15,1	8,0	5,9	3,1
Portugall	0,7	0,1	2,1	0,9	0,8	0,4	0,7	0,4
SUA	15,2	4,6	11,5	4,7	8,2	4,4	9,4	4,9
Turkey	12,9	3,9	15,8	6,4	7,5	4,0	3,8	2,0
Others BERD	13,4	3,8	6,9	2,6	3,0	1,5	7,2	3,6
<b>TOTAL</b>	<b>100,0</b>	<b>30,0</b>	<b>100,0</b>	<b>40,4</b>	<b>100,0</b>	<b>53,2</b>	<b>100,0</b>	<b>52,3</b>

Source: Romanian National Bank

Beside The Austria, France, important position in what look the foreign principal had to god-daughter years 2002, Greece (11,8), SUA (9,4), Holland (5,9), Italy (5) etc.

Remarked a significant decrease on last years Turkish principals (ab 12,9 in 1999 to 3,8 to god-daughter years 2002 September), as much pursuant to a sale were one to Romanian International Bank, but chiefly bankruptcies Turkish bank.

More and more else an assets has it European Bank of Reconstruction and which participants to the many maul banks were from. Romania (Transilvania Bank, Tiriac Bank etc.), With the possibility of increased these participants.

Although the Romanian banking system contains a relative little number of banks in Romania in inter-war period, but and with situation from another strong, the



degree of concentration of banking systems is erect, in the sense as the first 5 banks having near 2/3 from the banking market, and an alone the bank the one 1/3 from the market, thus:

### **Concentration degree of the banking system (first 5 banks)**

<b>December 2001</b>	<b>Mld. LEI</b>	<b>Mil. EURO</b>	<b>Percent (%)</b>	<b>Percent BCR (%)</b>
Assets	224.989,5	8.069,6	65,2	30,9
Credits	65.437,9	2.347,0	55,6	28,1
State titles	28.449,5	1.020,4	79,4	29,2
Warehouses	173.224,8	6.213,0	65,8	32,2
Own capital	31.603,9	1.133,5	65,2	36,4
<b>September 2002</b>	<b>Mld. LEI</b>	<b>Mil. EURO</b>	<b>Percent (%)</b>	<b>Percent BCR (%)</b>
Assets	272.870,2	8.393,9	65,2	31,9
Credits	86.160,0	2.650,4	55,0	28,7
State titles	29.782,0	916,1	77,2	26,5
Warehouses	204.812,9	6.300,4	65,6	34,6
Own capital	39.540,5	1.206,3	64,5	37,9

*Source: Romanian National Bank*

### **VIEW DEVELOPMENT BANKING DISTRICT**

In Romania, reform the banking advanced the reform economies on the whole or, this fact confer the banks a true role locomotive in the economic development.

In general line, is caned appreciated as, currently, reform the banking systems he finished, conversely, in economy exist still many which component registres losses from the activity unfurled, generate the important arrear, the reorganization and of a taking over industrial one power sectors, but don't except difficult before reflation registered a decrease is placed across the well known level .

With all these difficulties, inherence of which transition, opening with the year 2000, diminish were stopped were took again the process of economic growth, the moderate early maul and the then more and more supported.

Elementary component national economies systems, the financial market from Romania reflects through his evolution the stage touches in the realization and the operation structures saving of the market.

Binded of developmental stage banking systems, the monetary represented first functional link of periods transitional and, currently, with all favorable

evolutions determinate of the creation and the development capital market, maintains the important role in what looks the process of mediate financier.

The volume financial which resources can be actuating in the advantage at large economies and the of actors so-called market banking mediate, is a resultant a developmental economic degrees and capacity created and redistribute the value.

In Romania, the inherent difficulties periods transitional caused a permanent caned of came the populations and extreme economic agents, in these condition, the process of saves up he placed to one from most reduced levels in a row from The Central Europe and East Europe.

Banking warehouse at sight and to former term a reduced weight in the domestic gross product of Romania, inferior levels touches of another strong in transition and by a long chalk below one of saving of the market developed:

**Weight banking warehouses in PIB**

	<b>Romania</b>	<b>Poland</b>	<b>Czech Republic</b>	<b>Croatia</b>	<b>Slovakya</b>
Banking warehouses in PIB	22,8	39,0	60,0	62,0	66,0

Near the general developmental which level cause the relative little gainings, in our opinion, an important cause weight reduced the banking warehouses in PIB constituted a fact as the a good part from resource physical persons the juridical which and through their nature temporary available by-path and the therefore takes part in category resources of credit the by-path attracted state in the likeness of certificates of treasury.

A positive fact, carry were underlined, visa tendency of breed the weight banking warehouses in the domestic gross product registred in the year 2002, which tendency is caned maintained and consolidated on measure development economies on the whole or.

From component attracted of the banking system, merely a part is worth in the frame of credits transactions the real economies and the from this angle comparative with another strong central and the east European the shifting that Romania has it of retrieves:

### The banking system getting-in economy

- % -

		Romania	Poland	Czech Republic
1	% Banking warehouses in PIB	22,8	39,0	60,0
2	% nongovernmental credits in PIB	14,2	31,0	58,0
3	Placement warehouses in credits degree	62,2	79,5	96,7

From date presented, result as, as in Poland banking warehouse by-path placed in trust in proportion intimately 80, and in practical Czech Republic resources inveigled into the banks in the likeness of warehouses find in economy in the likeness of trusts, in Romania the degree of invest the banking warehouses in trust is much important, it causes deprive to the real economy of a tender big of trust an incident to the erect level of installments minimum compulsory reserves, not in last row, of the attractiveness still erect placements on the market.

The monetary market assures the proper term must of liquidity of commercial banks.

Currently, the average daily volume of transactions realized on the monetary market is aggregated one 150 USD, and the average daily volume of warehouses is of one 1,8 mld. USD, significant digit if direct to as, on total banking system, warehouse and the economies in lions and currency of populations and economic former touched cca 7,3 mld. USD to the end years 2002.

To have a clear image about volumes of funds reticulated toward fructifies wide of the circuit real economies, consider useful the specification as the, to the level balance-sheets unit of commercial banks, placement represents one 39, by a long chalk across the level registers in another economy from The Central Europe and of Est. From this angle is appreciated fit authorities "the banks prefer the saddle is gambled to a fault between they".

### Weight placements in all assets

	România	Polonia	Ungaria	Croatia	Slovacia
Banking placements/assets	39	24	16	16	14

Near the credibility and the solidity of bank, which are primordial, the banks must let us offers the depositors and an attractive interest, with the specification as

the, an interest drawn out from the market, how is said, must let us he comes on thought.

To be attractive, the interest must let us he exists positive, respectively with several point percentile across the level reflaction, so that, he who saves up the saddle is protects against erosion real value their economies pursuant to inflationary processes.

In conclusion, the intermediaries banking level in Romania, explicate through weight banking warehouses and trusts nongouvermental in PIB, is still reduced in comparative with our neighboring the very reduced and if advert to us the strong countries developed, with saving of the market consolidate.

From this angle, the banking activity in our country has a potential giant of growth in next year, when, on measure consolidation economies, is of waited the saddle increased substantially banking intermediary.

On the financial Romanian market is many developmental place and the from angle of meshes of territorial operative units (branch and agents) ale banking companies.

Currently, in Romania exist just 1,8 banking companies to 1 million inhabitants and 3, to 1 million population bankable, by a long chalk below the average level from the countries developed from The Europe and from world.

## **CONCLUSION**

Reform the banking advanced in Romania reform others economic sectors, the banks be in position drew after they real economy, to contributed each bank, likewise or else little, after still more selected power after interest and his strategy.

Although very slow, the process of reorganization and adapts the banking systems to requirement saving of were, finished broadly to god-daughter years 2005 with BCR private 61 percent.

The banking reorganization were a slow process very shy beginning in 1990, with a very slow evolution of he implements the mechanisms of operate his in saving

of the market. The responsibility in this sense coming back outside BNR, who he musted it besides of 55 his years regulate the introduction instruments of discounts and credits specific (order of the pay, check, bill of change, slip to order), likewise of 77 his years enters CRB and CIP, prerequisite for mechanism the check and monitoring the risk the commercial banks.

To god-daughter years 1998, begin the years 1999, with appearance Capital Basel According (Dir no. 12 From 2000 EH), BNR begins a process of banking supervision, bringing in this sense a series of concrete elementary of estimates the banks on the strength of systems of rating. In 2001 the system CAPL, that is.

- Declare principals (C)
- The active quality (A)
- Profitability (P).
- Cash (L),

from 2001 he completed it with the second component: "The quality" (C) and management (M).

In 2006 BNR and he proposed the introduction of the seventh indicator of banking rating sensitivities to the risk of the market, indicator concordantly with the settlements Basel II.

A special came back BNR along with inviter Romania of to UE in 1999 became member they, prepared the banking Romanian system for integration.

In this sense except in the year 2004 BNR:

1. Assisted in the process of treats for three one afferent chapter banking systems:
  - 1.1. Freely jobs circulation
  - 1.2. Freely principals circulation
  - 1.3. Economic and monetary Union.
2. The participation to monitoring achievement commitments assume through document of afferent negotiation banking systems

3. The participation to the elaboration sections to the banking banking sector from the frame p strategic afferent document processes of prepare the adhesion to UE

4. Preparation BNR for espousal of European System of Central Bank

The activity of management of projects PHARE of which takes BNR. With some months ante integration in European Union january 2007. Romania is in category<sup>1</sup> emergent markets beside The Bulgaria, with a banking market in transition. Having in sight the efforts do chiefly choosed from 1999 here of to BNR concerning banking systems, the rules prudential adopted in complet agreement with one European, precise as future banking Romanian systems is in a united Europa, and the steps do currently give us his law expect as such.

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<sup>1</sup> *Raport Erste Bank.*

# THE TAX CONTROL

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***Abstract:** Starting with the 1<sup>st</sup> of January 2004, the Code of Fiscal Procedure came into force by the governmental order nr. 92/2003. The Code adjusts the rights and obligations of the parts deriving from the financial juridic reports concerning tax management owed to the state and local budget as stipulated in the Fiscal Code. The Code regulations are applicable to customs rights management as well as to the management of the debts resulted from contributions, fines and other sums that represent incomes for the general agreed budget, according to the law.*

*Chapter IX contains the regulations related to the solving of the contestation formulated against fiscal administrative actions, as with beginning of applying these order regulation, the government order nr.13/2001 concerning the solving of the contestations against the measures disposed by control or imposing actions settled by the organs of the Public Finances Ministry.*

***Keywords:** the research, the control of documents, the stock-taking, the technical expertise and the laboratory analysis, the total control and the control by sampling, the confirmation of the findings by explanatory notes and finding notes, the analysis of the economic activity*

## **1. The concept of fiscal control, of taxpayer and fiscal inspector**

By fiscal control we understand the assembly of activities meant to insure the meeting of the obligations to declare and calculate correctly, and the payment in legal times of the contributions, taxes and other mandatory payments owed to the public budgets, local budgets and special funds budgets, generally called fiscal obligations.

According to the law, the following are subject to fiscal control: natural and legal persons, Romanian and foreign, that have fiscal obligations and who are called taxpayers.

Fiscal control is organized and functions at the level of General management of a district's public finances and of the Bucharest city, according to territorial components, and is carried out by the personnel with checking attributions who work at the Payment and Tax Office and its subsidiary units, who are called fiscal inspectors. The main object of the fiscal control activity is to obtain all the information necessary for checking the way taxpayers are fulfilling their fiscal obligations.

Fiscal control is about checking the declarations submitted by taxpayers, of the documents used for payment and tax setting, and other documents submitted by taxpayers with the aim of gaining some deductions, repayment or redemptions.

Taxpayers are obliged to sincerely declare, in legal time, their profit incomes, movables and houses in their property or gained by any other legal title, as well as other goods that generate titles of fiscal claims. When the law doesn't provide the obligation to submit an application of payment declaration, the taxpayers hold the responsibility for the right reckoning of the fiscal obligations, in the terms specified by the law. Also, the taxpayers are obligated to underline the gained profit and the payments made in their performed activities, by drafting the reports or any other documents specified by the law.

In order to control the way of discharging the tax liabilities, fiscal inspectors have the right to ask the taxpayers for any information, explanation or rationalization related to the declarations or any other documents submitted by them.

The fiscal control is programmed, organized and run during the normal working time of the taxpayer and, as much as possible, without disturbing the activity he/she usually performs. In all cases, no matter if the taxpayer has been or has not been notified about the inspection visit, the fiscal inspector has the duty to show the taxpayer or the person that represents him/her, the IDs that attest the inspector's



identity and official quality, and to announce, right from the start the objectives of the control.

In order to exert the fiscal control, the inspector has the right to enter any business area of the taxpayer or in other public opened area, without an earlier notification. The access is allowed during usual working hours, but outside the working program, the access is allowed only with an authorization signed by the fiscal unit's board, which explains the necessity of the control. In order to determine the payment obligations of the taxpayer, the fiscal inspector has the right to enter the house too, but only having the consent of the taxpayer or the property owner, depending on the case. Without permission, the inspector may enter the house only based on a judge decision, requested by the board for the fiscal unity, which has to motivate the necessity of a control inside the house. The taxpayer may ask for specialized or juridical assistance, all the way through the fiscal control.

Fiscal inspectors from the fiscal unities, but also the persons that do not have this quality any more, have the obligation of keeping the secret about the information related to taxpayers, that they acquired during the inspections. However, information regarding taxpayers may be transmitted only under the following circumstances:

- To other authorities with fiscal attributions, in order to fulfill some obligations which derive from the application of the fiscal laws;
- To labor and social protection authority, which makes payments for social insurances or other similar payments;
- To fiscal authorities of another country, based on a convention in order to avoid the double taxation;
- To competent judicial authorities, according to the law;
- To governmental officials, in order to use the information at drawing up statistics or in other analytical intentions, as long as it does not name the taxpayers;
- To another person only with the written consent of the taxpayer.

The person that receives the fiscal information, in the above mentioned conditions, is obligated to keep the fiscal secret about the received information. Disobedience to this obligation of keeping the fiscal secret is punished by the penal law.

During the fiscal control, the inspector is allowed to take or to make copies of any document or office record, as well as keeping any document or material element that may be used as a proof in determining the fiscal obligations of the taxpayer.

In order to develop the fiscal control at maximum conditions, the fiscal inspector may ask for the help, cooperation and assistance of the taxpayer or of the person representing him/her, which he/she is obliged to provide.

## **2. Procedures, techniques, and instruments of the fiscal control**

The fiscal system represents the way of research and action, the procedures and the modalities of investigation, in order to prevent, note and eliminate the cases of circumvention from calculating, accounting and paying the taxes deserved by the state.

The fiscal apparatus, as part of the fiscal system, fulfills its functions of making admeasurements, setting, following and collecting taxes and levy, through fiscal control. The way the fiscal control is organized, the procedures, techniques and means applied differ from one system to another, from one stage of market economy to another, depending on the financial and economic policies.

The fiscal control, regardless of who made it, requires the submission of several activity rules and the enacting of some specific procedures, techniques and means or instruments of control, that are generally valid.

Fiscal control may be classified by several criteria, as follows:

**1. From the point of view of the reason for performing it, the fiscal control may be:**

- Informative: it has an educating character, it informs the newly registered economic units about their rights, but above all, about their fiscal obligations;

- Routine control: which has the role to maintain the connection with the taxpayers and to oversee their way of obeying the obligation to register themselves as tax and levy payers, and the way taxpayers obey their fiscal obligations.

**2. From the point of view of the composition of taxes and levy, fiscal control may be:**

- General: when all taxes and levy owed by the taxpayer are comprised in the fiscal control. This kind of control is considered normal and it is realized at the office of the payer. Its target is to control all the aspects regarding compliance of the taxpayer with the fiscal laws and regulations, for a longer period of time, usually from the last fiscal control till up to date;

- Partial: when the control refers only to specific taxes and levy.

This classification is conditioned by the competences and the experience level of the fiscal agent. General control applies to economies with incorporated fiscal systems, while limited control may be found in countries with separate administrations for taxes and levy.

**3. From the point of view of the operations submitted to the fiscal control, fiscal control may be:**

- Complete: when all operations, documents, or periods regarding accounting and tracing of a tax are controlled;

- Selective: when only certain operations, documents, or periods regarding accounting and bookkeeping of a tax are controlled.

The choice of one of these methods depends on a series of factors: the amount of activity, the tasks of the fiscal inspector, the financial status of the company, the antecedents of the company, the seriousness of the taxpayer, etc. If the selective control reveals defalcation, fiscal inspection continues, resulting in a full control aiming to find the reality and to determine the real dimension of the taxpayer's obligations.

**4. From the point of view of determining the reality of some operations that lead to obligations to the state, fiscal control may be:**

- Documentary: when the fiscal inspector examines the form and the content of the bookkeeping, in order to determine the truthfulness and legality of the operations, based on the documents submitted by the taxpayer. The main objective of the control is to compare the accounting records and the primary documents with the data taken from the declarations and deductions submitted by the taxpayer, in order to establish the correctness of the payments, as well as to oversee the conforming to the payment terms;
- Factual: when the aim of the control is to attest the existence and the shrinking of the material and financial means, and the way those are reflected in the documents. This is to know the sincerity of the taxpayer when drawing up his/hers bookkeeping and declarations, as well as to identify the cases of tax evasion.

The Economic guard, along with the fiscal apparatus, integrates and fulfills its distinct role within the fiscal system, taking into account its specific fiscal control duties, tasks and procedures. One must keep in mind that the activity of the Economic guard does not overlap the activity of the fiscal apparatus, the two institutions complementing one another, as long as they work in unison and have the same objective.

The specific procedures of the economic guard when it comes to a fiscal control are:

- **Operative and unexpected control** – which may be carried out in any place where operations are displayed and documents are drawn up, issues that give rise to financial obligations (a storehouse, public houses, outbuildings, customs houses, harbors, airports, markets, fairs, etc.). This procedure requires a mix of several forms of control (through surveys, factual and documentary) and cannot be integrated in a control program established in advance. Such a control is in fact a form of investigation and requires, first of all, a preparatory activity: observation,

data and document collection, and choosing the optimal moment for carrying out the control;

- **The mutual and crossed control** – requires close and complex research when confronting the data and information given or collected by clients, purveyors, custom-house body, different institutions, natural persons, etc. with those from the declarations and bookkeeping of the taxpayers. The aim of such a control is to identify omissions, incongruence or malevolence, and as a result, to identify evasion from fulfilling the fiscal obligations. This kind of control consists of several investigation visits, to several economic units, that are related through contractual relations, and its aim is to control the data throughout the entire process that includes the production, the manufacture and the trade of the goods included in the contract;

- **Group control** – requires unexpected and simultaneous control at all companies that have financial and commercial links between them (usually companies that share the same associates or shareholders, subsidiaries, dependent companies, holdings, etc.). The aim of this control is to establish the legality and reality of the operations carried on between the above mentioned businesses, the truthfulness of the bookkeeping records, in order to find out the cases of financial evasion. This procedure also requires the mixing of all forms of control (factual, documentary - secretarial, crossed, total and through surveys) also having knowledge of collateral domains (juridical, trade, etc.);

- **Diagnostic control** – is a thematic control, which presupposes the examination, the global investigation of a company in order to establish its financial correctness. This control is short timed and evaluates the seriousness of the taxpayer. Should this control reveal defalcation, it leads to a complete control, which is usually accomplished by the financial inspectorate to which it belongs. It is done likewise, bearing in mind the fact that the control of the Financial guard should not surpass 8 hours.

The reason for those two financial controlling institutions to exist is only given by their specific procedures. The necessity to include in the control the entire matter

liable to tax, of all taxpayers, also justifies the functioning of those two institutions, especially in the actual phase, which may be described by a collection of wild and primitive assets, in which contraband and financial evasion are getting stronger every day. In the same time, the interference between the activities of those two institutions may be seen as necessary also for insuring a protection of the moral and professional profile of the control body. Repetitive or heteronymous control, as long as it is not noxious to the taxpayer, may prevent, stop, and disclose some tendencies towards corruption inside the system and may reveal the lack of preparation of the inspectors.

Instead, the activities of those two institutions must be accomplished in a unitary frame and in fact to complement one another. Taking into consideration the common aim the two institutions follow, constant exchange of information is a must.

A first step towards real collaboration would be to put together a common data base (of the financial files sorted by categories of economic units), realized by the fiscal inspectorate, and which should cover all verifications made at one taxpayer, despite the body that completed the control. The financial clerk is given the task to correct the level of all taxes and levy, depending on the notes included in the investigation papers, to monitor and collect the taxes and levy owed to the state, having as such, the main role in insuring the exploitation of the notes concerning taxes and levy.

### **3. Means of performing and finishing the fiscal control**

Fiscal control can be made upon declarations and other documents submitted by the taxpayer in order to gain some tax deduction, repayment, reimbursement or in order to gain something else, without making the inspector go to the taxpayer's company or house. In this case, the inspector may ask the taxpayer any information, reasoning or explanation regarding the declarations or documents submitted through a letter or during a meeting at the headquarters of the fiscal institution. The letter or the address of the meeting must always include the date till which the taxpayer must send the answer and the date at which the taxpayer must come to the fiscal institution,

as well as the problems for which the inspector demands explanations or the problems that will be discussed at the meeting.

In case the taxpayer does not respond to the above mentioned demands, a control at the company is scheduled.

The fiscal control at the company or house of the taxpayers will proceed, primarily, based on the accounting records and evidence for taxpayers that, according to the law, must have such bookkeeping of the basic documents, or based on the factual findings regarding ownership of goods or developing a liable to tax activity. The fiscal control at the company also extends on other elements that can directly or indirectly contribute to the assessment of real fiscal obligations of the inspected taxpayer.

In the case of natural person taxpayers, the fiscal inspector may perform a general control of the financial status regarding assessment of income, taking into account the concordance between the declared incomes, on one side, and patrimonial status and living standards of the taxpayer, on the other.

The necessary time for the fiscal control, be it at the business headquarters or the house of the taxpayer, is established by the fiscal clerk, in a differentiated approach, depending on the real objective of the control, the period submitted to control, the category the taxpayer is part of, the total rate of turnover, and the complexity of the developed activity.

Maximum length of a control activity is of 3 months, despite the period of activity or the place submitted to control (taxpayer's company or house).

Fiscal control of the way financial obligations are fulfilled by a taxpayer during a period of time may be performed one time only. A new fiscal control that investigates the same period of time is not allowed, regardless of the authority that supervises the second control.

The conclusions of the financial control are recorded, as a mandatory task, by the fiscal clerk in the document named "Statement of control", signed both by the fiscal clerk and the taxpayer. In case the taxpayer refuses to sign the statement, this fact is noted in the statement of control, fact that will be communicated to the

taxpayer through a registered letter demanding receipt confirmation, in 5 days after the registration of the statement at the fiscal institution.

The statement of control includes the unfolding of the control, the deficiencies found, indicating the legal instructions that were infringed, as well as the actions taken throughout the process of control or the actions that are to be taken in the future to facilitate the remedy of the observed deficiencies.

Should the conclusions of the statement of control reveal some actions that fall under the incidence of the Penal code or other laws that include penal stipulations, the findings will be noted separately in a “Statement of findings”, which will include the legal instructions infringed and the persons involved, if known.

The statement of control, approved by the manager of the fiscal institution to which the inspector that made the control belongs, is an executory title and follows the specific juridical regime.

The instructions noted in the statement of control must be fulfilled by the taxpayer, in 7 days time starting from the announcement of the control’s conclusions; otherwise they will be fulfilled through means of enforcement, according to the law.

If the taxpayer considers that the instructions written in the statement of control are incorrect, he/she may submit a request of reappraisal of those instructions, in 5 days from the announcement of the control’s conclusion, at the General department of public finances, which is obliged to make a statement by a justified decision communicated to the taxpayer, in 30 days from the date of the registration of the request.

Against the decision emitted by the General department of public finances of the district or of the city of Bucharest, the taxpayer may call in question the Ministry of Public Finances, the latter being obliged to answer in 40 days time, by a justified letter, addressed to the taxpayer. The decision of the Ministry of Finances may be contested at the Court of Appeal from the territorial range in which the taxpayer is located.

During the process of solving the request of reappraisal, and depending on the case, of the contestation, the taxpayer is suspended from the obligation to fulfill the



instructions specified in the statement of control, within 7 days from the notification, signed up, of the decisions emitted by the body to which the taxpayer submitted the contestation.

The fiscal inspector may start establishing officially the fiscal obligations of the taxpayers, in the following situations:

- If the taxpayer didn't submit the fiscal declaration in time;
- If the taxpayer didn't give the fiscal clerk the solicited information, justifications and explanations, that are to help the latter to correctly establish the fiscal and non fiscal obligations;
- If the taxpayer refuses to let the inspector fulfill the fiscal control;
- If the taxpayer is abroad.

If the fiscal inspector, after controlling the declarations submitted by the taxpayer, decides that establishing the fiscal obligations was not made according to the law, he/she may start another examination of the documents. The taxpayer has the task to prove in the abovementioned situation that the fiscal obligations established by the fiscal inspector are not real.

The quantum of fiscal obligations established for the above mentioned situations are to be communicated in writing, along with the way of their establishment, and the taxpayer is forced to pay his dues within 7 days from the date he/she received the communication.

The stipulations regarding fiscal control also apply to the control run by other bodies than, according to the law, have fiscal control attributions, as well as to the control run by the fiscal inspectors, based on the attributions stipulated by the law upon other obligations of natural or legal persons, Romanian or foreign.

#### **4. Opinions and conclusions**

The tax dodger phenomenon is an inherent coordinate of the market economy. This is why, the most efficient attitude against this phenomenon is to realize a good

management in order to identify it, anticipate it, control it and put it to good use, in order to insure the projected incomes.

The tax dodger phenomenon must be evaluated in its whole complexity, taking into account, along with its negative connotation, its impact upon the multiplication of the sums collected by the state, as a result of identifying the cases of fiscal evasion. The multiplication factor of the fiscal evasion may be taken into the account of meeting the budgetary deficit, with the necessary precautions.

In addition, a deep analysis of the internal mechanisms of the evasions phenomenon is required, an analysis which would permit deceleration of some instruments and means of controlling the phenomenon.

Concerning the fiscal and financial control, it has to identify the instruments and the indicators which could insure the functionality of the economic system in legal parameters, mostly under the impact of possibility of control, rather than under the simple control. The orientation of the control must be targeted towards control through exception and less towards the permanent and excessive control.

From this point of view, the control strategies should be elaborated in a more flexible manner, in order to describe the cases of fiscal evasion not as a result of an exhaustive control, but as a result of intimation of some difficulties, specific to the management of public incomes.

For as long as anyone can remember, tax payment was imposed to the citizen by law, the latter considering it, from human related reasoning, as a confiscation of his/her incomes in favor of some unrealistic and unrelated to him/her objectives. This may be the explanation why some taxpayers try to evade from paying taxes and levy, as a reaction to the state's "attempt" against their freedom of using their full income.

It is thus created a state-taxpayer "conflict" and the stake is fiscal evasion.

Thinking from the taxpayer's point of view, his/her arguments seem to be right, especially when payments are excessive and it becomes an impediment against individual prosperity. Without taking into consideration the general interests of the state, it would be wise to take them into account only when the battle against fiscal evasion is held in case of a reasonable financial system, situated at a minimum level

of normal and efficient functioning, and also, in case this battle looks forward to equity regarding taxation.

Unfortunately, none of these positions (that of the citizen and that of the state) allows us to draw up an objective analysis of the fiscal evasion phenomenon. The human being cannot be placed outside its social context; this is why, the research of the dodging phenomenon must look without taking sides, for the interest of both the taxpayer and the state.

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# **How could Romania avoid the threat of payment default in 1999 and at what price? Lessons for the future<sup>\*</sup>**

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## 1. Short economic background

Since 1991, the Romanian economy has gone through two recoveries and two contractions.

The economic contraction at the onset of the transformation process was very severe, real GDP having been in 1992 down by 8.8 percent as compared to 1991.

The first economic recovery covered the period 1993-1996, when real GDP grew at an average annual rate of 4.1 percent.

Throughout the second economic contraction (1997-1999), real GDP declined at an average annual rate of 4.1 percent.

The second economic recovery has started in 2000, with real GDP growing by 2.1 percent, and continued in the following years at a rate of 4-5 percent, reaching maximum of 8 percent in 2004 and then slowing down to 5 percent in 2005.

### 1.1 First recovery

Referring to the first recovery, Romanian real GDP grew in 1995 at an impressive rate of 7.2 percent. It went on growing in 1996 too, although at a lower rate of 4 percent.

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<sup>\*</sup> Main data are from Ministry of Finance, National Bank of Romania, International Monetary Fund

At the same time, inflation – as measured by the GDP deflator – accelerated from 32.5 percent in 1995 to 45.2 percent in 1996.

Regarding the export of goods and services, they increased from USD 7195 million in 1994 to USD 9404 million in 1995 to reach USD 9648 million in 1996.

However, the current account deficit worsened from USD 428 million (1.4 percent of GDP) in 1994 to USD 1774 million (5 percent of GDP) in 1995 and USD 2571 million (7.3 percent of GDP) in 1996.

According to the IMF report “Romania – Recent Economic Developments” (SM/97/ 94), the monetary policy accommodated the increased deficits in the general government and state enterprise sectors and became highly expansionary from mid-1996.

Credit growth, side by side with sharp increases in real wages and the budget deficit, drove the economic recovery through 1996.

Output and export growth were led by traditional, energy-intensive industries, so that the IMF staff concluded that the economic recovery through 1996 was unsustainable.

The quasi-fiscal operations of the central bank significantly contributed to this outcome.

Having nearly depleted its reserves in 1995, NBR took advantage of credit ratings received on the basis of the extension of the Stand-By Arrangement in December 1995 and borrowed USD 1.5 billion at relatively short maturities from international capital markets in 1996. Romania went to the capital market for 7 credits: 2 were credits in euro and 5 were bond issues in euro and in yen. The maturity for a good part of these credits was 36 months that means payment concentration in 1999.

The replenishment of reserves allowed NBR to intervene in the foreign exchange market to slow the depreciation of the ROL.

Concerning inflation, measured as consumer price index it surged in the second half of 1996, reaching a monthly rate in excess of 10 percent by December. Underlying inflation was significantly higher as price controls and exchange rate manipulation almost halved energy prices in real terms and caused a serious overvaluation of the ROL.

By end-1996, the premium in the parallel foreign exchange market reached 30-40 percent.

The current account deficit surged in the last quarter of 1996 alone to about USD 1 billion, mainly on account of energy imports.

At the onset of 1997 Romania was on the verge of a financial crisis that required corrective action.

## 1.2 The economic program

The program of the government, supported by a stand-by agreement with the IMF, aimed at macroeconomic stabilization and acceleration of structural reforms. Without entering into details of the Program, I would only emphasize the two key components of it:

- The liberalization of the foreign exchange market;
- The increase of energy prices towards their border parities.

In the first place, the use of the exchange rate prior to 1997 as an overt means to subsidize energy-intensive enterprises had caused a persistent overvaluation of the ROL and the imposition of restrictions on the foreign exchange market.

The liberalization of the foreign exchange market in 1997 was accompanied by a severe downward correction of the ROL.

The exchange rate – annual average – depreciated from ROL 3083 per USD in 1996 to ROL 7168 per USD in 1997.

In the second place, domestic prices of energy were increased, having as target their border parities – as defined by the international prices of competitive imports at the market-determined exchange rate.

Consequently, in 1997 average domestic prices of electricity, heating and natural gas were 3.17 times their average levels in 1996.

We can try to explain the effects of the 1997 economic program:

On the one hand the exchange rate depreciation that accompanied the liberalization of the foreign exchange market was a positive shock on aggregate demand, stimulating the exports and discouraging imports. On the other hand the increase of energy prices towards their border parities was a negative shock on short-run aggregate supply, diminishing the gross domestic product (GDP).

We can say that the demand shock impacted positively on real GDP, while the supply shock impacted negatively on real GDP. However, both shocks entailed a higher general level of prices.

On the positive side the exchange rate depreciation stimulated exports and discouraged imports.

Thus, the exports of goods of services went up from USD 9648 million in 1996 to USD 9955 million in 1997 (an increase of 3.2 percent).

At the same time, import of goods and services went down from USD 12503 million in 1996 to USD 12349 million in 1997 (a decline of 1.2 percent), net exports having a positive contribution to GDP.

However, overall real GDP dropped in 1997 by 6.1 percent. What happened? One explanation is that the negative supply shock induced by the increase of energy prices apparently was stronger than the positive demand shock due to the depreciation of the exchange rate.

It is worth mentioning that other government actions were also at play in 1997 determining the contraction of GDP. Here are some of them:

-Tight macroeconomic policies (the reduction in the budget deficit and the control of the monetary expansion) induced a strong negative shock on aggregate demand.

-The cut of subsidies, previously granted to the energy-intensive enterprises and the agricultural sector, was another negative shock on the supply side of the economy.

In spite of these measures inflation in 1997 was significant at 147.3%, measured on the basis of the GDP deflator. The tight macroeconomic policies were unsuccessful in containing inflation because of the negative shocks on the supply side of the economy.

## 2. Worsening economic situation in 1988

In a few words, in 1988 the economic situation in Romania was characterised by contraction, inflation, an external deficit of about 7 percent of GDP and an overvalued currency (ROL). On top of these developments Romania had to pay, on the account of foreign debt, 2.2 billion USD out of 2.3 billion USD foreign reserves.

All in all, against this evolution of the economy, we will try to respond to the following questions related to the further economic developments in Romania in 1998:

What was the impact of the Russian crisis on the ROL exchange rate against the USD?

How did exchange rate movements relate to other economic variables – interest rates, prices, the GDP rate, Romanian exports and imports?

How did ROL overvaluation against the USD relate to the loss of foreign exchange reserves?



## 2.1 Market sentiment towards Romania

Market sentiment toward Romania worsened after the Russian crisis in August 1998. Moreover,

creditors focused their concerns on the external deficit of Romania, together with the peak of external debt service scheduled for 1999. Consequently the major rating agencies downgraded Romanian sovereign ratings.

The first rating for Romania after 1989 was done in 1996 before launching a Eurobond issue. According to the Annual report of the NBR for 1996, Romania was rated similar with other countries from the region (BB<sup>-</sup>). This rating was not conducive to investments but the payments from the part of the issuer were quite probable.

During 1997 the above mentioned grade was maintained, but starting with 1998 the level has degraded, reaching in 1999 the level B and even B<sup>-</sup>, which means high level of risk. Below this grade is the grade CCC<sup>+</sup>, which means high probability of default.

At end-1998, the spreads between the Romanian external debt in a very thin secondary market and comparable US treasuries bonds were about 13 percentage points.

## 2.2 Major macroeconomic indicators

What happened with the major macroeconomic indicators?

Two outstanding events significantly impacted upon the exchange rate in 1998:

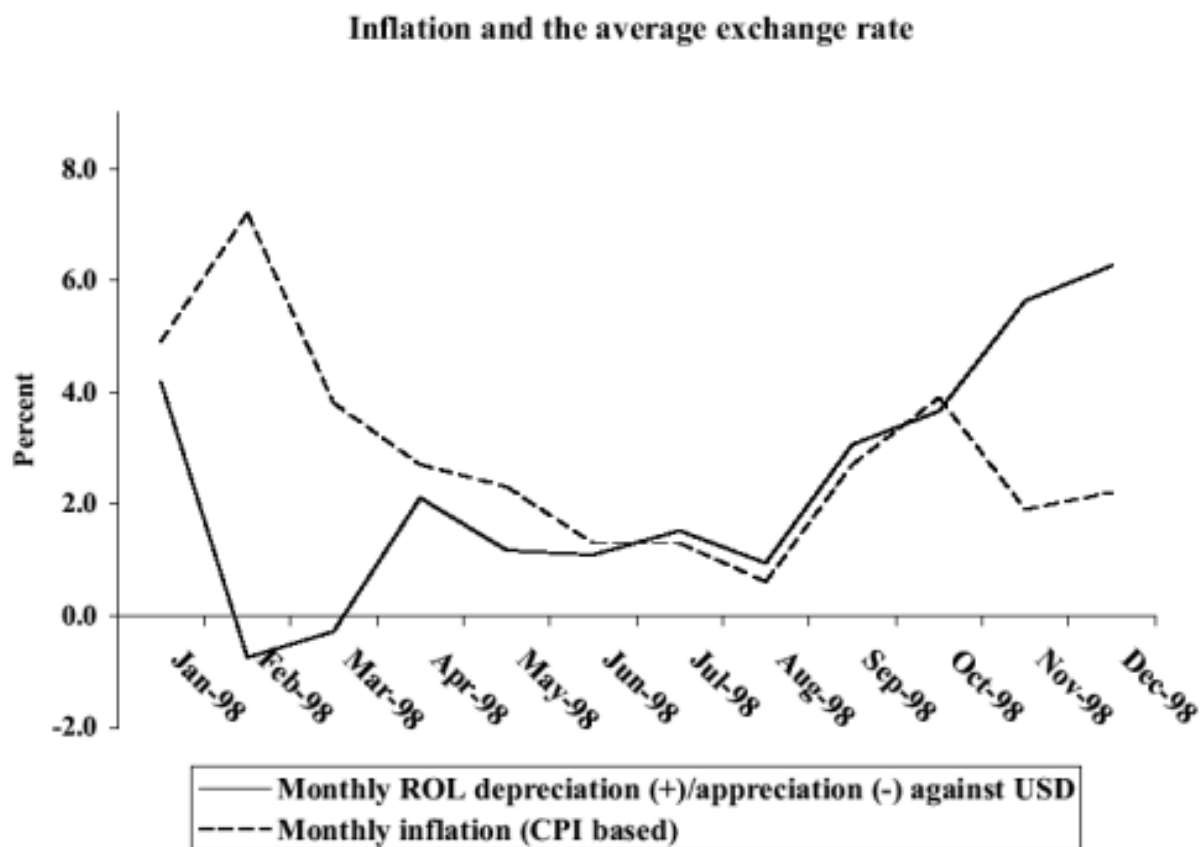
- The Russian crisis in August caused a serious turmoil on international financial markets and changed the market sentiment towards emerging economies, including Romania;

- Official foreign exchange reserves of Romania declined from USD 3 billion at the end of 1997 to USD 2.3 billion at the end of 1998.

## Inflation and the exchange rate in 1998

Inflation was in 1998 much lower than in 1997, but persisted at a relatively high level, consumer prices having been in December 1998 by about 41 percent higher than in December 1997.

The chart hereafter shows that the inflation rate was well above the percentage change in the exchange rate throughout the first half of 1998.



Because of the fact that the change in the exchange rate was well below inflation, the ROL turned significantly overvalued against the USD by mid-1998. However,

inflation took its toll in the end and the accelerated depreciation towards the end of 1998, as well as in early-1999, corrected ROL overvaluation.

But now was the turn of the overvaluation to take its toll, through the net exports. Exports of goods and services dropped from USD 9955 million in 1997 to USD 9519 million in 1998, while imports of goods and services increased from USD 12349 million in 1997 to USD 12798 million in 1998.

The practice shows that the economies with strong export-led recoveries of real GDP tend to see their currency appreciating. By contrast, domestically driven recoveries of real GDP tend to increase the demand for imports, so that the domestic currency depreciates.

On the other hand, countries experiencing deep contractions of real GDP often find that their exchange rate is weakening. Traders in the foreign exchange markets may take GDP contractions as signs of general economic weakness and “mark down” the value of the currency.

Following the contraction of 6.1 percent in 1997, real GDP further declined in 1998 (by 4.8 percent).

Note that imports increased despite the contraction of the domestic economy, which points to the severity of ROL overvaluation.

The prolonged economic contraction appears to have played its role in worsening the market sentiment towards Romania and putting downward pressures on the ROL.

### 2.3 Central bank interventions

To put it simple there are two polar options of exchange rate regimes:

-In the regime of flexible or floating exchange rates, the rates at which currencies exchange for one another are determined by demand and supply.

-In the regime of fixed exchange rate, the central bank intervenes in the foreign exchange market to offset the rate changes that fluctuations in demand and supply would otherwise cause.

But in Romania there is a regime of managed floating. This means that the exchange rate is essentially determined by demand and supply, but the central bank may occasionally intervene to smooth market fluctuations. Thus the exchange rate is the price in ROL of foreign currencies, USD for example (ROL per USD), so that an increase of the exchange rate means ROL depreciation and USD appreciation.

Recall that the decline of interest rates by mid-year and the relatively high inflation put downward pressures on the exchange rate in 1998.

Despite these pressures, the ROL was grossly overvalued against the USD by mid-year because of National Bank of Romania (NBR) interventions.

As indicated by the decline of official reserves, NBR was a net seller of foreign exchange on the market. NBR interventions increased the supply of foreign exchange, which contributed to ROL overvaluation.

But can central banks defend an overvalued exchange rate indefinitely?

The answer, based on practice, is obviously no. The foreign exchange reserves will, other factors equal, be exhausted in the end.

The same thing happened in the Romanian case, when market participants understood towards the end of 1998 that the exchange rate was unsustainable. Consequently expectations of downward correction of the ROL firmly consolidated, and it made no sense to the central bank to go on fighting against such strong expectations.

### 3. The threat of payment default in 1999

On top of the worsening economic situation, the external debt service (amortization plus interest) was scheduled to reach a historical high in 1999.

The service of the medium and long-term external public debt amounted in 1997 to USD 1581 million and in 1998 to USD 1520 million. It was programmed to surge to USD 2160 million in 1999.

At the same time the gross foreign exchange reserves (including gold) of the central bank amounted at the end of 1998 to only USD 2299 million.

Against the background of the widening current account deficit and the historical peak of the external debt service, the level of reserves was not at all encouraging to financial markets.

The strong market sentiment at the end of 1998 and early in 1999 was that Romania would default on its external obligations.

We will try to respond to the following questions:

How could Romania avoid the threat of payment default in 1999 and at what price?

What were the impacts of the 1999 fiscal and budget adjustment on interest rates, the exchange rate and the deficit of the external current account?

How did real GDP and inflation respond to the adjustment?

### 3.1 Fiscal and budget adjustment in 1999

In 1999 a new finance minister was nominated, and a close cooperation with NBR has developed to ensure that Romania will be capable to pay its obligations.

In this context, the government, supported by the IMF, embarked upon a drastic fiscal and budget adjustment in order to reduce the current account deficit, consisting of:

- Tax increases – notably social security contributions, excises and property taxes;
- Elimination or suspension of previously granted tax facilities and exemptions;
- Expenditure cuts – notably wages in the public sector and capital expenditures.

Tax increases was the main component of fiscal adjustment.

The fiscal and budget adjustment was accompanied by structural measures aimed at curbing the operating deficits of state enterprises and banks. Also the speed of privatization was pushed at maximum, 1999 being an outstanding year.

### 3.1.1 Budget revenues in Romania

Romanian budget revenues amounted in 1999 to 31.9 percent of GDP, as compared to

29.7 percent of GDP in 1998. Note that the budget revenues increased significantly, reaching almost 1/3 of the GDP; this was a huge effort.

However, the most important increase from 8.9 percent to 10.7 percent was registered at social security, and we consider this measure as a big mistake; social security is a part of labour cost and its increase was conducive to underground works. In other words this means a significant taxation in labour.

What taxes should have been increased more in 1999?

In our opinion the answer is excises taxes. This is because the bulk of these taxes are supported by consumers and in 1999 it was a need to restrain consumption in order to repay the debt. Moreover, according to the EU Acquis Romania has to have a minimum level of excises, and this minimum was significantly higher. Note that excises taxes increased from 2.3 to 3 percent and the property taxes from 2.1 to 2.7 percent.

The adjustment in 1999: budget revenues

(Percentage of GDP)

	1998	1999
Budget revenues	29.7	31.9
Current	29.7	31.8

Tax	27.8	30.1
Profit tax	3.0	3.1
Income tax	4.0	3.2
Social security	8.9	10.7
VAT	6.0	6.0
Custom duties	1.5	1.4
Excises	2.3	3.0
Other	2.1	2.7
Non-tax	1.9	1.7
Capital	0.0	0.1
Grants	0.0	0.0

### 3.1.2 Budget expenditures in Romania

Romanian budget expenditures amounted in 1999 to 34.7 percent of GDP, as compared to

35.1 percent of GDP in 1998.

The adjustment in 1999: budget expenditures

(Percentage of GDP)

	1998	1999
Budget expenditures	35.1	34.7
Current	30.9	31.7
Goods and services	11.4	11.5
Wages and salaries	5.0	4.9
Material expenditures	6.4	6.6
Interest	4.7	5.2

Subsidies and transfers	14.8	15.0
Subsidies	1.7	1.6
Transfers	13.1	13.4
Capital	3.6	2.8
Lending minus repayments	0.6	0.1

### 3.2 Deficit financing in Romania

The budget deficit shrank from 5.4 percent of GDP in 1998 to 2.8 percent of GDP in 1999.

Domestic borrowing contributed the most to the financing of Romanian budget deficit both in 1998 and 1999.

Privatization revenues and bank asset recoveries represent special means of deficit financing in Romania.

The bank asset recoveries refer to bad bank loans, which, in the context of banking reform, were transferred to the public debt.

The adjustment in 1999: budget deficit financing  
(Percentage of GDP)

	1998	1999
Financing	5.4	2.8
Domestic borrowing	3.9	1.6
External borrowing	0.0	0.4
Privatization revenues	1.8	0.9
Bank asset recoveries	0.0	0.0



Discrepancy -0.3 -0.2

### 3.3 Real GDP and inflation in 1999

The fiscal and budget adjustment in 1999 played its part in entailing a decline of 1.2 percent in real GDP.

However, inflation – measured on the basis of the GDP deflator – dropped from 54.1 percent in 1998 to 47.8 percent in 1999.

### 3.4 Interest rates in 1999

Interest rates on government borrowing stayed relatively high in 1999 because of the likelihood of payment default. They surged at 104 percent in May on account of the scheduled peak of external payments. Against the background of lower government borrowing, they subsequently declined to about 70 percent towards the end of the year.

The pessimist market sentiment explains why investment spending did not positively react to the decline of interest rates. Consequently gross fixed capital formation was in 1999 down by 4.8 percent. However, lower interest rates played their role with a lag, gross fixed capital formation having picked up in 2000 by 5.5 percent.

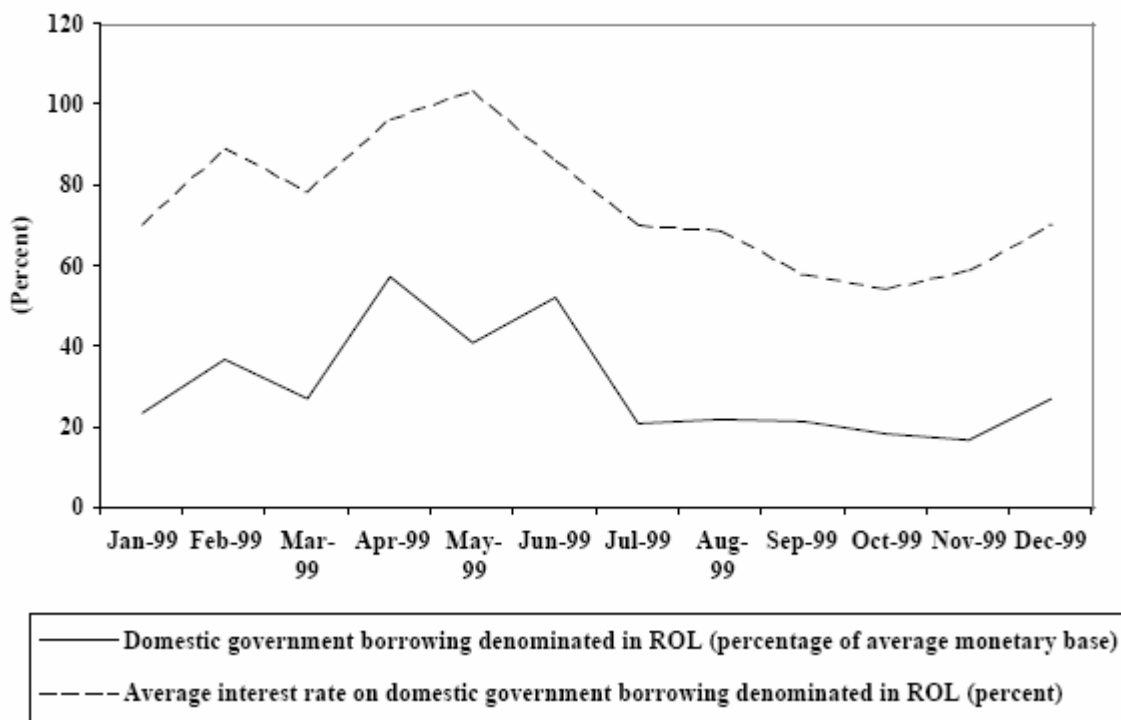
The decline in the domestic borrowing by the government gradually lowered interest rates.

Domestic government borrowing is measured in the chart hereafter on a gross basis (new borrowing plus roll-over).

Note that the monetary base adds up the currency in circulation and the reserves of commercial

banks.

### Domestic government borrowing and interest rates



### 3.5 The exchange rate and the external current account in 1999

The ROL depreciated in 1999 by 72.8 percent against the USD, which was well above the inflation rate. This was a support for the exports of goods and services which were up by 3.5 percent (from USD 9519 million in 1998 to USD 9854 million in 1999).

At the same time imports of goods and services were down by 9.8 percent (from USD 12798 million in 1998 to USD 11538 million in 1999). All these developments were favourable to a reduction of the deficit of the external current account to USD 1469 million (4.1 percent of GDP).

### 3.6 Foreign exchange reserves in 1999

Market expectations that the central bank would exhaust its foreign exchange reserves in 1999 did not materialize. Romania could meet its external obligations and, moreover, increase its reserves because of the improvement in the current account, which, in turn, was induced by the

Foreign exchange reserves of the central bank increased to USD 2493 million towards the end of 1999.

Eventually Romania avoided the threat of payment default but the price paid for this success was the GDP decline. However, had the situation of payment default occurred, the associated financial turmoil would have presumably caused a much larger drop of real GDP.

### 3.7 Changing the rating

A positive change in rating for Romania came only on September 2002, to the grade B and than in 2003 to BB, and it was only on September 2005 that Romania got the investment grade of BBB<sup>-</sup>.

Romania came back to the capital market on October 2000 with a bond issue of 150 millions USD for 36 months at 11 percent, and than on November 2000 with a similar bond issue but at 11,5 percent. This was followed in 2001 by a 600 million bond issue at 10,625 percent and another one in 2002 for 700 million at 8, 5 percent. One can notice the diminishing of the risk premium for Romanian borrowings, and the hope is to be able to borrow in the future at 4-6 percent.

# **Practical issues in valuing Romanian Financial Investment Companies**

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*This paper is dealing with practical valuation issues concerning Romanian Financial Investment Companies – the five SIF's. The focus is on some of the most relevant approaches to the value estimation of SIF's shares: the net asset value, the adjusted net asset value, the premium and discounts, the price per book value ratio, the Tobin's "q", the total shareholder return (RTA). We do not stress upon issues well debated in the financial local community, like PER, but we believe that the topics we discuss is able to add value to the investors and analysts attempts to estimate the intrinsic value of a complex financial instrument – SIF's equity.*

We must state from the very beginning that any attempt to estimate the value associated to the property rights over an issuer is subject to bias. All the relevant data and information are available at different levels to the public and the differences through professional knowledge of valuation and experience in capital markets among appraisals conduct to a **range of values** instead of a **single value consensus**.

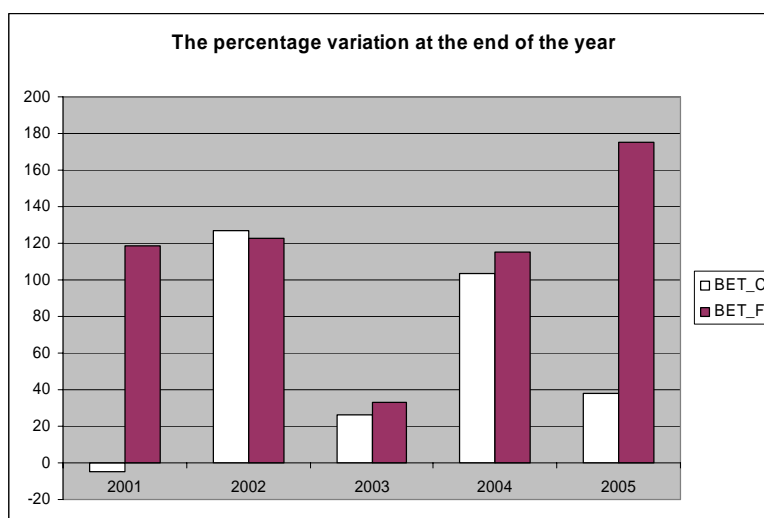
The value assessment of both, closed-end companies and public companies is affected by subjectivity in the reasoning of the valuers. Romanian capital market presents the characteristics of a "**real emergent market**", meaning: informational asymmetry, insufficient transparency, financing deficit and lack of liquidity, authorities interventions to "regulate" the free market. The importance of appraisals is recognized on any market, but in emergent ones their contribution to the development of investment process is even greater because the poor secondary market of different assets.

## 1. The Romanian Financial Investment Companies – the five SIF's

Romanian Financial Investment Companies (SIF) act as joint stock companies, being listed at Bucharest Stock Exchange (BVB), first tier under the tickers SIF1, SIF2, SIF3, SIF4 and SIF5. The number of shares outstanding is fixed and the share price is a function of the specific demand and offer.

There is an obvious correlation between share price and the image and reputation of a public company. In this respect, trust in the competence and honesty of the management is among the most important investors criteria. The competence is easy to be measured starting from the main objective of the public issuer: **maximizing shareholders value**. From SIF's part, this can be done through two different approaches:

- ⇒ maximizing the share value, result depending on factors like the size and consistency of the profits and the net asset value, but also on the company reputation and the management of public relations, the actions of different groups of interests, and so on;
- ⇒ maximizing the dividend flow, result depending on the quality, type and structure of the portfolio of financial assets, in other words the investment policy.



**Graph 1** The percentage variation at the end of the year for BET\_C and BET\_FI

Graph 1 presents the percentage variation at the end of the year, between 2001 and 2005, for the five SIF's index – BET\_FI versus the market index BET\_C. With a single exception, the year 2002, investing in SIF's shares was far more productive than buying the market index, for example.

In terms of market capitalization, at the end of the year 2005, the market value of the five SIF's was 1,77 billion EUR versus 15,31 billion EUR, the whole market capitalization, respectively 11.6%.

Constantly, during the considered period, the value and volume of transactions with SIF's shares were a major part of the whole market. These short regards are meant to emphasize the real interest of local and abroad investors in these issuers, the subject of the paper.

## **2. Relevant approaches to the value estimation of SIF's shares**

### ***2.1 Net asset value – the equity capital divided by the number of shares (1)***

Economic investor's decisions depend on the quality, consistency, accuracy and comparability of the financial reports of the funds. The key to estimate the value of a SIF is the value of its financial assets portfolio. The net asset value (NAV) is a first hint of the potential and hidden value of portfolio assets, representing crucial information either for "investors" or "speculators", financial analysts, appraisals or brokers in the meaning of potential price per share in the hypothesis of willingly liquidation. Compared with the market value this indication supports the transaction decisions, either speculative or long term.

The maximum informational relevance of the NAV would be obtained only if **all portfolio assets are liquid**, or the possibility to be all sold very quickly at the market value once the selling decision was taken. Due to the emergent market characteristics emphasized in the introduction, we underline that a great part of the five SIF's portfolio assets are partially illiquid and involve a great deal of time, due-diligence and negotiations to be sold at an appropriate value.

In Romania the value of equity capital is calculated through an administrative type of valuation<sup>1</sup>, imposed by the Romanian National Securities Commission (CNVM) and does not reflect at all the attainable market value of the SIF's portfolio assets. First at all, for the listed assets, the price considered is the average price of a three months historical period, procedure that does not capture the value at the valuation date of the instrument.

For the unlisted assets, like closely held companies, the considered value is an asset based value, with discounts regarding the level of control reached by SIF and this method is totally ignoring the potential, the perspectives and the risks associated with a particular company. So, there is a lot of place for a better approach.

## **2.2 Net adjusted value per share - NAV adjusted**

### **The equity adjusted capital divided by the number of shares (2)**

What we propose here is simply to perform an adjustment to the portfolio of each SIF by replacing the value comprised in the CNVM's equity valuation with the market value at the valuation date. Due to the fact that each SIF has to report the full portfolio at the end of the month, this adjustment can only be done at the end of a month, based on the monthly report to the BVB.

Practically, each position, listed at the BVB is reconsidered based on the market value and not the average price in the last three months. The corrections, even if are done for the main positions of listed assets, could reveal great differences between the reported value and the attainable value, which, of course, could be a good support for investment decisions types like "buy" or "sell".

We only need to highlight exposures like BRD (Roumanian Bank for Development – Societe Generale), TLV (Transilvania Bank) or SNP (PETROM – OMV) and one can understand the importance of the adjustments. Even for closely-held companies like BCR (Romanian Commercial Bank – Erste Bank), the acquisition price is a better achievable value signal than the accounting equity value.

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<sup>1</sup> For details, please see "Regulamentul 15/2004" issued by CNVM, at [www.cnvm.ro](http://www.cnvm.ro) .

### 2.3 Premiums and discounts on the net asset value (3)

The main characteristic of an investment trust like a Romanian SIF is that it can be traded with a premium or a discount versus the net asset value. The amount of such a difference depends on the market perception regarding the financial results, the trust and competence associated with the management, or other market general and specific factors. The significance of the premiums/discounts is, somehow, the same as PER's for the common shares – the market image and “sentiment” over a marketable instrument, a barometer of investors opinion about the SIF's shares value.

$$\text{Discount / Premium} = \frac{\text{Share price} - \text{Net asset value / Share}}{\text{Net asset value / Share}} \quad (3)$$

If the share price is lower than the Net asset value/Share than it's selling at a discount, and, respectively, if the share price is higher than the Net asset value/Share it's selling at a premium. Accordingly to the Net adjusted value per share, the discount/premium can be expressed as a function of the adjusted value, with an increased relevance in this case.

$$\text{Discount / Premium} = \frac{\text{Share price} - \text{Net adjusted asset value / Share}}{\text{Net adjusted asset value / Share}} \quad (3.1)$$

The net asset value is a better indication for the value if the portfolio of the investment company contains more liquid assets. This could be more easily performed in a mature economy, with a strong and functional financial market.

For emergent markets, like Romania, the importance of the eventually adjustments is greater, because of the less liquid portfolio of SIF's than the portfolios of other international listed companies, like the family of investment trusts, in Great Britain, listed at the London Stock Exchange. Anyway, a less liquid portfolio is perceived by the rational investors as being a more risky one and the return expectations are higher.



## 2.4 Price per book value PBV (4)

Book value offers an indication regarding the hypothetical cash left to the shareholders after the selling of all the company's assets at the book value and the payment of all the debts. Book value reflects historical costs paid to constitute the firm's assets while the market value of the company's equity reflects, among others, the capability of the company's assets to generate future cash-flows and profits.

$$PBV = \frac{\text{Share price}}{\text{Book value per share}} \quad (4)$$

The discussion of the relevance of such a multiple for investors in SIF's shares comprises the same aspects as those revealed at the points 2.1 and 2.2, regarding the capability to sell quickly the assets at their market value. Otherwise, PBV is totally irrelevant and could be misleading.

## 2.5 Tobin's "q" (5)

Tobin's "q" is a rate proposed by the economist James Tobin and is particularly useful in analyzing SIF's share value and represents the market value of the invested capital (VIC) divided with the estimated replacement cost of the enterprise assets (ERC). Computing this rate for a SIF involves the study of the balance sheet and of the portfolio reported to BVB.

$$q = \frac{VIC}{ERC} \quad (5)$$

If portfolio's assets are liquid, ERC can be approximated at the net asset value level, otherwise adjustments are needed. For a public company like SIF, the market value of the invested capital is the sum between the market capitalization (MC) and the market value of debt (MVD).

$$VIC = MC + MVD \quad (5.1)$$

## 2.6 Total Shareholder Return TSR (6)

As SIF's constantly distributed dividends and experienced a huge appreciation of the value of the equity, TSR represents, for sure, the most relevant ratio when analyzing a SIF. TSR shows both the growth due to the share price increase and the growth due to the dividend distributed.

$$TSR = \frac{P_1 - P_0}{P_0} \times 100 + \frac{D}{P_0} \times 100 = \frac{P_1 - P_0 + D}{P_0} \times 100 \quad (6)$$

Every investor, accordingly to the timing of his investment in SIF's shares and if he is entitled to dividends for the holding period, can very simply compute this ratio and compare the result with other alternatives. We illustrate this operation for 2005 in the Table 1 below:

<b>Annualized returns of different investment alternatives (%)</b> <b>31.12.2004 - 31.12.2005</b>		
1	Average annual bank interest*	7.6%
2	BET_C	38.22%
3	Mutual Fund Index as published by UNOPC	14,74%
4.1	TSR SIF1	201.2%
4.2	TSR SIF2	218.6%
4.3	TSR SIF3	108.2%
4.4	TSR SIF4	203.4%
4.5	TSR SIF5	202.9%

*\*estimated as an arithmetic average of passive banking interests published by top 10 Romanian banks*

Table 1

## 3. Conclusions

Net asset value has an increased relevance in SIF's versus the NAV of an operational or commercial company. Anyway, the adjusted NAV is even more significant and helps the investors to reduce the bias linked to administrative values.

Discount and premiums of SIF's share prices over the net asset value per share are particularly significant for investors. The Tobin's "q" is useful if goes with the Price per Book Value because it helps to a better understanding of the sources of value.

The most relevant ratio is, with no doubt, the Total Shareholder Return. It allows investors to decompose the sources of growth and to compare the return of investment in SIF's shares with other investment alternatives.

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## **On the parameters of financial management within insurance companies**

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Decebal Manole BOGDAN, PhD

*Insurance industry is developing due to the need of protection of the modern man against the risks whom is the subject to. Careful enterprises of the development of economy have established commercial entities that take over(assume)the risks from the bearer in exchange for an insurance premium. The aim is to set up a rewarding businesss. A question arises, which of the parameters of the financial management influences the aim of the insurance company(profit for the shareholders, protection for the insured, taxes and socio-economic balance for the state administration in case of calamity).*

### 1. introduction

insurance company is an economic entity founded to manage the risk communities and to generate profit. Actully, it's an economic manager that uses the drawn mutual funds, indemnifies the equivalent of the risks purchased by the insured persons, in case that damages and body injuries occur, and invest the created technical reserves by financial instruments with a view to maximize the profit.

The background of the financial management in insurance have an aim, an areal of operation and a frame work. The main parameters of the financial management are in fact the followings: capital; subscribed and paid-up insurance premiums; commitments of indemnification and insured amounts; technical reserve; assets; technical and financial results and not at least, solvency margin. Surveying the parameters of the financial management isn't accidentally but having a logically and naturally succession.

We consider that the management of the insurance company performs in connection with the financial management. Management decisions are taken regarding the vectors of influence: shareholders, insured persons, state administration, socio-economic factors and employees. Shareholders want to increase their fortune on dividends basis, the increase of the firm(company)'s market value, but more directly the increase of the profit. The stockholders have a responsibility regarding the insured persons to whom they've promised the compensations of the losses from the transferred risks.

## 2.the capital and the asset of the insurance companies

### 2.1 the capital. Structure and formation

Regarding the concept of capital, some researcers consider it's an economic category with an historical nature.The first shapes of the way that capital acts, took the shape of the commercial capital that contributed to the developing of the merchandises trade and then in the shape of the usurious capital reflected by "money trade" interest bearers. The capital may be phisical or currency, fixed or working, social or stockholders'equity and it's defined as a " stock of valuables or assets which entered the economic circuit, may generate revenues for their owners". The economic process of insurance requires the presence of some formation levers of capital called sources. By sources it's understand the reserve of means susceptible to be used on a certain occasion. Following some analysis, we can distinguish the two features that make sens to capital, the movement and the value. From the setting up point of view,

the stockholders' equity named also nominal capital stands for the valoric expression of the amount, of the individual contributions of the holders of the company. In its structure we find called up share capital and the long term borrowed capital. The insurance companies usually don't appeal to long term borrowed capital. The stockholders' equity consists of called up share capital, additional paid-in-capital, revaluation reserve, profit and loss account brought forward, current profit and loss account, subsidies, reserves. The has been defined as "the accrued personal welfare" too that the entrepreneurs find it in the manufacturing process. The capital have to yield a normal yearly profit, consisting of a certain amount of money or goods. The financial capital is synonymous with the net assets/stockholders' equity, being defined in the terms of the nominal currency measure. The phisical capital is regarded as the operating capacity in the terms of the manufacturing capacity.

## 2.2. the structure of the capital in an insurance company

The capitalization of the insurance company takes place by the contributions in money and in kind that the shareholders have committed to put it to the commercial company's disposal. The structure of the capital stands actully for the division of the capital in shareholders capital and borrowed capital or the proportion in that the shareholders capital is divided into common shares or preferred stocks.

The stockholders' eqiuty of an insurance company represents the total of capitals, owned by the shareholders, that are entered the liabilities and consists of: called up share capital, additional paid-in-capital, the, retained earnings, revaluation reserve, subsidies, profit and loss account brought forward and other asimilated items. We think that there are no differences of interpretation between the modern outlook of the capital and the classic one (marxist). In the classic outlook "the working capital that enters the manufacturing process conveys to the product its entierly value and so it should be continuously replaced , in kind, through the selling of the product; if it comes out that the manufacturing process will proceed without stoppage. The fixed capital that enters the manufacturing process conveys to the product only a part of its value (tear off by depreciation) and continue to operate in

the the manufacturing process despite the tear off. The marxist theory analysis the capital through the way in that it takes part to the added value, organized in permanent capital and variable capital. The permanent capital is defined as “ that part of the capital that turns into means of production, namely in raw materials, auxiliary materials and means of labour, it never changes the scope of the value in the the manufacturing process. The variable capital represents “ the part of the capital turned into labour force, it changes its value in the the manufacturing process. It reproduces its own equivalent and more than that a surplus, plus the value that in its turn may vary, to be bigger or lower”.

In the case of the insurance companies, it can be obviously noticed the variable capital. The permanent capital doesn't create a new value (added value), being a requirement of the added value formation and appropriation. The resources of the capital's formation are multiple. The intern financing set up by the use of the resources from the inside of the company (self financing, yielding of assets and resources generated by the operating process). Outside financing relies on drawn resources by capital formation and increase, short, medium or long term loans,, dividend and interest. We can talk about real and financial capital. Insurance companies being economic entities whose field of activity is to render financial services, the basic analysis of the stockholders' equity is made after the the financial capital with a significant weight in the real capital. The currency capital is a form of the capital advanced for the formation of the insurance fund. Moreover, over-structural it's an asset with a particular nature, the currency, that allows taking some risks. By assuming the protection against some risks, by the insurance policies, generates financial flows, the currency expression of the real flows

The legislation requires a minimum stockholders' equity for an insurance company, but this doesn't represent the most important parameters of the financial management. Its part is to initiate the bussiness and to enable to the company to operate for at least a beginning period of time until the covering of the potential and effective expenses of the insurance premiumm's mark up percentage.

The called up share capital is relevant in the moment in which the management of the insurance company incurs financial losses. The financial losses are covered from stockholders' equity. Practical the capital is a factor of equilibrium of the economic activity, being preserved after the beginning of the activity.

## 2. the revenues of the insurance premiums.

The revenues are increases of economic flows in the shape of assets entries, increases of the assets' value or decreases of the debts that turns into an increase of stockholders' equity (other than the one resulted from the shareholders' contributions). The economic activity from the insurance companies whose aim it's yielding a more profit relies on the mobilization of some revenues that comes out of the selling of insurance products, financial investments and the rational usage of the insurance funds for indemnifications, regarding only the payment of the proper amounts.

The main elements that make up the revenues of the company are the amounts or the values collected or that are to be collected from: carrying out the contract obligations regarding the insured; advantages that the company accepted to receive; carrying out some legal or contract duties regarding the third parties; extraordinary revenues.

According to the law, the accountancy of the revenues is kept on categories of revenues, that are classified thus:

a) operating revenues comprising : subscribed gross premiums to optional and compulsory third party liability (TPL); reinsurance premiums; compensations recovered from the back civil actions and paid by embezzlement; rendered services; dues; rents; releases of technical reserves; tangible fixed assets production; standing for the cost of the works and expenses performed for the firm itself, that are entered as tangible and intangible fixed assets, operating subsidies, standing for financings that the company enjoys, granted by the state or by other companies. Other operating revenues are the revenues of the recoveries related to the common insurances, revenues from the reactivated debts and other untechnical revenues.



b) Revenues from investments consist of interests and fructifications of the capital and technical reserves, valuable bonds, in investments; bank interests, in the placements of the currency supply, in bank deposits and at sight. This category comprises all the revenues resulted from the investment of the fund and the reserves in economic activities approved by the law in order not to affect their financial stability. According to the law the investments can be made only to some banks approved by the National Bank of Romania and ISA.

c) extraordinary revenues comprising of those revenues that aren't linked to the current normal activity of the insurance company. In the cases in which the persons blamed for the damage incurred to the insured are third parties that haven't taken out a valid third party liability, the regress action is started.

d) Revenues from provisions and the adjustment to the inflation, comprising the revenues from the provisions for charges and liabilities, provisions for the depreciation of the tangible fixed assets and for other assets items, revenues from the negative goodwill, revenues from the provisions regarding investments. Depending on the moment of establishing and entering them the accountancy can be outlined the following categories of revenues: predictable (entered in the moment of the selling of the insurance policies); committed (their collection is done in the majority of the cases after the conclusion of the contracts); established in the moment of their collection (are entered in the accountancy in correspondence to the cash accounts); reckoned (don't suppose any collection resulting, only book keeping, from provisions cancellation).

The revenues of the insurance companies come mostly, from the subscribed insurance premiums and in little of investments or stockholders' equity operations. As a parameter of the financial management, the gross subscribed insurance premiums are relevant if they rely on secure insurance contracts and collected on the agreed terms. This parameter is analysed in connection to the cancelled insurance premiums. There is an isolated and sequential practice to subscribe premiums and to cancel them after due to the fact that the insured doesn't pay the premiums when they fall due. Drawing up some contracts when it's known from the beginning the fact that it's

realized by the unpayment of the premiums, it's a method of deceiving the vigilance of the public regarding the real volume of the turnover. Comparison to the indemnifications paid or to be paid of the insurance premiums will reveal to us the efficiency of the activity.

### 3. the structure and the way of the expenses' assessment.

The expenses represent the consumptions of labour and material determined by the operation of the insurance company. They comprise the values paid or to be paid for: damage and performings; staff expenses; purchasing expenses regarding the insurance contracts; carrying out some legal or contract duties; consumptions, the works carried out and the services rendered and other expenses.

The expenses of the insurance companies represent actually decreases of "economic outcomes" taking the shape of outlets or decreases of the assets value, or increases of the debts, that materialize in decreases of the stockholders' equity (other than the distributions to the shareholders).

To ascertain the result of the financial year within the expenses are comprised the expenses regarding the technical reserves; depreciations and the established provisions; book value of the conceded, destroyed, lack at the stock taking assets; the expenses with investments and other expenses. In the financial accounting entering the expenses rely on grouping them according to the nature of the operating, financial, extraordinary activity and to the nature of the resources employed, personnel, depreciation, indemnifications and paid insured amounts. In the cost accounting, the expenses are grouped by their destination and function on insurance lines and on categories of insured. According to the legal regulations, the expenses' accounting is kept separately for the life insurance activity and for the common insurance activity, on kinds of expenses, by their nature and destination.

#### 4.1. classification of the expenses by their nature

(1) "the operating expenses comprise the expenses regarding; a) damage and performings; b) technical reserves; c) employees and agents; d) reinsurance commissions; e) consumptions of consumables, fuel, spare parts, inventories;

f) expenses with the works and services carried out by the third parties (maintenance, repairs), dues, rents, studies and researches, expenses with other work and services carried out by the third parties (agents, protocol expenses, advertising, transportation of goods and personnel, temporarily transfers, postage and telecommunication fees, bank fees and others); f) losses of debts, fines, penalties, donations and granted subsidies, expenses regarding the yielded assets and other capital expenses.

(2) the expenses with the investments and other expenses consist of : a) losses of debts related to the participating interests; b) expenses related to the yielded investments; c) financial expenses regarding the depreciation of the debentures redeemed premium; d) expenses related to the differences of exchange rate; e) expenses with the interest f) related to the discounts granted; g) other similar expenses.

(3) extraordinary expenses represent that expenses that aren't related to the normal, current activity of the company (expenses due to the calamities and other extraordinary events);

(4) expenses with the depreciation and the provisions comprise: a) depreciation of the tangible fixed assets and work in progress of the investments' nature; b) depreciation of the tangible fixed assets of the nature of other assets; c) depreciation of the debentures redeemed premium; d) provisions for charges and liabilities; e) provisions for the amortization of the tangible fixed assets; f) provisions for the amortization of other asset items; g) provisions regarding the investments; h) the expenses for the adjusting to the inflation.

(5) the expenses with the income tax reckoned according to the law.

#### 4.2 expenses on destinations

The main destination of the expenses represents the financial cover of the commitments towards the insured or the victims by the payment of the value of the damage incurred by them. Although the damage stands for a parameter that influences directly the financial value of the company it can't be quantified but assessed. The real ascertaining occurs post factum. Optimizing such a parameter involves prevention

and control measures of the embezzlement and of the poor management of the company.

## 5. Reserves

Not to affect the stability and the solvency of the company, it is created for each line of insurances special fund called technical reserves. This immobilized amounts are created while operating at a level at least equal to the total amount of the indemnifications paid previously financial year. Technical reserves should have in any moment a sufficient value to allow the company to advance, in a predictable manner, commitments that result from the insurance contracts. Technical reserves are entried distinctly , according to the given destination having posts created in the chart of accounts. The general principal of these kind of reserve is that it's established from the moment of the conclusion of the insurance contract and are maintained over the validity period of time. It's obviously that there are established bigger reserves at the life insurances than at the common one's. The cause is represented, along the increase of the life insurance premiums collected, and applying of the prudential norms.

5.1. Premiums reserves are reckoned separately for each insurance contract. They are exceptionally situations in which the reserve is reckoned on statistical methods and especially on proportionally and lump methods. Their average will have approximatelly the same value as in the individual reckonings. For establishing the value of the premiums reserves ( $R_p$ ) are used informations from the insurance contracts , established with the help of the relation:  $R_p = (Z_r : P_b) \times P_{sn}$ , where ,  $Z_r$ - number of days corresponsing to the unexpired period of the contract;  $P_b$ - period of the contract, expressed in number of days;  $P_{sn}$ - net underwritten premiums for the mentioned contract.

Reserve creates a balance of the results comparing the collected premiums with the ucollected insurance premiums and it's balanced periodically at the date of the collection of the falling due insurance premiums installments.

5.2. Damage reserve. This kind of reserve is created and realized monthly on the assessments for the approvals of damage received by the insurer so that it will be sufficient to cover the indemnifications for the damage. It's established separately for each insured case. This reserve should take into consideration also the damages occurred at the end of financial year, but undeclared. The main purpose of the reserve regards the the expenses for the settlements of the damages, no matter of their insurance. In the case in which the indemnifications take the form of annuities, the value of the reserves is established employing actuary reckonings.

5.3. Reserve for unapproved damages is created and adjusted at the end of the financial year based on statistic and actuary reckonings for un-occurred and unapproved damages. The reckoning is based on using any reliable, real information, about the occurrence of the damage on methods personally to each insurer. The reserve is released at the same time with the approval of the damages by the insured persons or the persons that suffered the losses, depending on the case. Actually it's transferred to the damage reserve.

5.4. The reserve for unexpired risks is reckoned on the assessment of the damages the can show up after the end of the financial year only in the case it comes out that the assessed damages exceed the value of the premiums reserves. Mathematical relation is:  $R_m = D_{est} - R_p$ , where  $D_{est}$ - assessed damages, that can occur in the next period of time and  $R_p$ - premiums reserve.

5.5. Equalization reserve. To establish a medium term balance In the years with favourably technical results, technical reserves are to be set up that will serve as covering sources for the damages that occur in the years in which the results won't be favourable, actualy it's a dispestion of favourable results of the current financial year in the following years. The set up may take place only if the damage rate related to all classes of operated insurances it's below 50%. The reckoning of the reserves is done cording to the relation:  $R_d = (D_{prn} + D_{rnd}) / (P_{ms} - D_{rp})$ , where  $R_d$ - damage rate,  $D_{prn}$ -net reinsurance premiums paid,  $D_{rnd}$ - variation of net damage rate,  $P_{ms}$  – net underwritten premiums,  $D_{rp}$ - variation of the premiums reserve. Equalization reserve

can not exceed 3.5% of the volume of the net underwritten premiums related to the year in which the reckoning is done:  $Re \leq Pns \times 3\%$

5.6. Calamity reserve is established by applying minimum 5% on the amount of the gross underwritten premiums related to the insurance contracts that cover the catastrophic risks. Their value can't exceed 10% of the accumulation of the liabilities assumed by the insurance contracts that cover catastrophic risks. The main destination of the reserve are the indemnifications for the damages that will occur as a result of the occurrence of catastrophic risks. Although the interwar legislation stated the means of investing the technical reserves, the legislation issued after 1990, haven't specified a prudential way of investing the established reserves. Only in the year 1996 the prudential norms regarding the liquidities keeping and the invested placements of the companies operating in the insurance field. The companies operating in the insurance field, have the legally duty to take the following measures:

- a) cash at hand and at bank (current accounts, bank deposits, and other deposit instruments) are to be kept in at least two commercial banks, but no less of 50% in a single commercial bank;
- b) invested placements in a single investment fund can't exceed 20% of the total amounts invested in such kind of funds;

Accounting ensures the book keeping of the technical reserves established by the company according to the legal regulations. Insurance companies are complied by the law to establish and maintain the categories of the technical reserves stipulated for the law. The other categories of technical reserves, namely reserve for the participation in results and returns regarding the common insurances, damage reserve regarding the life insurances and other technical reserves regarding the common insurances are established and are book-kept according to the legal regulations.

The amounts transferred to the technical reserves, established and maintained according to the legal procedures, stand for liabilities of the insurer and are deducted of its revenues with a view to establishing the profit. In the cases in which the insurance contract earmarks premiums collection and foreign currency indemnifications, the related technical reserves can be established and maintained in

foreign currency. Foreign currency technical reserves are entered in accounting using the national legal tender LEI, at the exchange rate in force at the date on which the operations are made. The technical reserves are stock-taken and assessed at the end of each period of time. The assessment methods of the technical reserves employed by the company (prorata temporis, statistical a.s.o.), should be the same over the financial year, as from one to another. In explanatory cases and according to the terms stipulated for the legal regulations, the company may change the methods of assessment, registering them in the notes to the account, disclosing the influences to the financial position, as to the financial performances. Practic the reserves have a decisive part in ascertaining the credit rating and the solvency of the insurance company. Their administration is done by: setting up, up dating, investing, realeasing have an important part in the stability of the insurance company. There are insurance companies that have unfavorable results due to the fluctuation of the technical reserves. A large insurance company that takes out under one year hired insurance contract will have a bigger negative result than in the situation of taking out the same contracts but with full payment of the premiums.

Although the technical reserves are monitorized by the ISA following some algoritms it can't be determined a standard of risk to ensure the perfect administration of the technical reserves.

## 6. The insurance companies assets and the solvency margin

The assets of the insurance companies comprise fixed assets, current assets investments-fixed assets. There are insurance companies that operate on the classical system with fixed territorial structures (premesis, cars, furniture and other (equipments) that are comprised in the category of tangible and intangible fixed assets. Modern management preferes a mobile structural organization without owned premesis. The spaces where they operate are mostly hired, and the means of transportaion are leased. The system has an increased economic efficiency because it doesn't immobilize financial resources by purchasing assets. Order no.6/2001

released by the ISA settles the categories of assets allowed to stand for technical reserves, the rules of disposition of the investments as the liquidity coefficient too.

The categories of the assets allowed to stand for the insurer as technical reserves are: government bonds issued by the public administration authorities, land and buildings, bank deposits. Bank deposits will be opened only if the commercial banks have a called up share capital more than 10.000.000. Euros. In the case in which the deposits are opened at the subsidiaries of some foreign banks, their called up share capital should be of minimum 4.000.000. Euros. The liquidity coefficient is given by the ratio between the liquid assets and the current liabilities of the insurer towards the insured. The liquid assets are: government bonds that are traded employing the services of commercial bank authorised by the NBR and if they have a called up share capital of at least 10.000.000. Euros and bank deposits whose amount doesn't exceed 25% in a sole bank and 20% in a bank belonging to the same financial group as the insurers or to the significant person of the insurer's stockholders.. the amounts invested will be of maximum 50% of the called up share capital of the nominated bank. The doubtless current liabilities of the insurer comprise damage reserve and the unapproved damage reserve. To have a satisfying liquidity coefficient the weight of the current liabilities in the liquid assets should not exceed 50%.

Solvency margin correlates with the assets, being the result of the ratio between contract liabilities and the value of the net assets. Solvency margin stands for the surplus of all company's assets over the demand of solvency.

According to the norms released by the ISA become effective in 12.31.2004, the degree of the solvency of a company is established as a ratio between net asset and the minimum solvency margin, ratio that, in the case in which it's under one or equal to one, shows that the company is insolvent or on the edge of insolvency. To prevent the state of insolvency, the company's executives should be monitoring constantly the assessment of the assumed risks, the assets that should be free of charges, the established technical reserves, the damage rate for each class of insurances, the



concluded re-insurance contracts and the last but not the least the investments policy and to send to ISA any recorded change of the solvency margin under the limit of 1.5.

In the case of the insurance companies that are authorized to take out common insurances, the net asset recorded in the year 2004 by the 38 companies had been of 9.365.651.945 thousand lei (236.130.700 EURO), in nominal growth of 14.33% given the situation of the year 2003, that means a real growth of 4.60%. From the analysis of the displayed data, result that on 12.31.2004, two companies had a under one solvency degree, namely: OMNIASIG-ASIRAG, whose degree of solvency was 0.69, and PETROAS, whose degree of solvency was 0.72.

Of number of 22 insurance companies authorized to take out life insurances possessed a totalized net asset of 1.997.131.748 thousand lei (50.352.514 EURO), a 61.19% nominal growth more than of the situation given in the 2003 and applying the inflation rate, results a real growth of 47.47%.

Looking over the situation on insurance market in the year 2003-2004, we noticed that the solvency margin isn't the only indicator that discloses the value of the company on the market. The lack of poise is displayed in the picture no. 1 and it's given by the disproportion between the net asset of the company and its liabilities given the low number of the concluded insurance contracts. The paradox of the situation is illustrated by the OMNIASIG ADDENDA company that has a called up share capital of 15.000.000 lei, a total asset of 7.042.073 lei and gross underwritten premiums of 1.604.877 lei (the last in the rankings). The large insurance companies, that possess a great portfolio both valoric and numeric it's harmonized in a solvency margin from 1.58 to 3.36.

The aspect needs to be pointed out because it can be noticed the extremely huge differences between the value of the assets, of the liabilities and the market

share that the company possessed. In the picture displayed above it can be easily noticed the ratio between the solvency margin and the assets of the insurance company. Important insurance companies have a unitar solvency margin while the insignificant insurance companies have an exponentially solvency margin. This concludes that the indicator displaying the solvency doesn't expres the reality only if it's analized in a larger context..

The authority that ules over the insurance field has settled beginning on decembre 27 2001, the norms regarding the minimum limit of the solvency margin both for the comun insurances and for life insurances. From mathematiclly point of view the solvency margin is given by the differences between the assets of the insurer and its liabilities defined by the norms issued by the ISA.

$$M_s = X/Y$$

Where,

$M_s$ - the solvency degree

$X$ - stands for the net asset or the insurer' solvency margin

$Y$  – stands for the minimum solvency margin

$$X = C - D$$

The assets that are taken in the consideration to the determination of the solvency margin “ C ” are:total assets “A”, according to the balance sheet of that the assets not taken into consideration are deducted “B” (intangible fixed assets, unquoted shares, part of the techicle reserve regarding the insurance contracts yield in reinsurance, pledged or mortgaged assets). The total of the liabilities “D” that are taken in the consideration to the determination of the solvency margin result by summing up: net technical reserves, provisions for charges and liabilities, deposits received from the reinsurers, debts, except from the loans from the issuances of debentures, half of the value representing subordinated debts.

The reckoning of the minimum solvency margin takes into consideration the ratio between the gross underwritten premiums of that the cancelled premiums are deducted and yhe average of the indemnifications paid and of the damage reserves of the last 3 years.

7. financial results- parameter of reflecting the quality of the financial management.

The difference from the revenues and expenses as we mention represents a gross result of the economic activity, called profit. Particular to the insurance companies is the deduction of the technical reserves from the gross profit before taxing it.

Result management is different from those of other economic entities due to the fact that the price of the insurance product sold isn't known in the moment of the transaction, bearing the item called risk. It can be made a comparative analysis of the insured's financial results towards the results of the insurer. Due to the adherence nature of the insurance contract, the insurer selects a range of commercial risks out of the multitude of the possible risks so that the economic activity should generate profit. A second filter is the level of the insurance premium that it's settled with a 5-15% included profit margin. An insurance with a high risk will have a greater insurance premium. A third filter is the progressive confinement of the indemnification: to the extent of the damage, real value, insured amount, value of the novelty, a.s.o. and the application of the deductible franchise per event or by applying the malus penalty. The above mentioned parameters represent only a part of the parameters that influence the direct results.

## 8. Conclusions

The financial management of the insurance companies involves streamlining, operation and the monitorization of the activities so that the interconnection of this parameters should be performed. The process of the financial management implies some restrictive requirements:

- a) the setting up of the called up share capital and maintaining it within the minimum limits set by the legal regulations;
- b) assuming some commitments regarding the approved portfolio structure and in close relation to the financial capacity to cover the potential damages;

- c) the set up and the management of the technical reserves in connection to the risks' structure, the evolution of insurance premiums collection, indemnifications paid and the reinsurance policy;
- d) performing the investments (of capital, reserves and other available money flows) in terms of safety and efficiency;
- e) the accurate proportioning of the expenses and thire effect in terms of necessity and oportunity;
- f) fair tracking and reflecting of the financial results;
- g) the compliance and the applying of the management decisions.

#### Titlurile la bibliografie

1 mechanism of the management of the insurance companies

2 informational system within the insurance companies

3 Commercial insurances

4 financial accounting

5 consideration over the concept, content, structure and the sources of formation of the capital

6. dictionary of political economy

7 company contract

8

9 the evolution of the economic thinking

10 the fiscal enviroment and capitalization

11 the capital

12 international accounting standards

13 State interference in insurances

14 law no. 47 regarding the formation, organization and operation of the commercial companies in the insurance field, issued in The Gazzette, part1 no.151 on june 19 1991

15 order of the finance ministry no. 1385 on June 26 1996 for the approval of the prudential norms regarding the keeping of the liquidities and the investmental placements of the companies in the insurance field, issued in The Gazette, part 1, no. 135 on June 28 1996

16 norms no. 5/2001 regarding the methodology of reckoning and keeping of the minimum technical reserves for the activity of common insurances, issued by the ISA, reissued

## **BANKRUPTCY IN THE BANKING SECTOR. MAJOR IMPLICATIONS FOR TRANSITION COUNTRIES**

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*All transition countries have experienced banking crisis or severe banking distress during the transition process. Key factors contributing to banking crisis in these countries have been the large amounts of bad debt inherited from the previous socialist regimes, and the lack of familiarity of enterprises and banks with the functioning of market economies. Therefore, the resolution of banking crises in these countries can also be viewed as a challenge of banking sector development in the transition context. While some transition countries have progressed more than others in developing and strengthening their banking systems, many have not completed the transition process. To this extent, new banking crisis remain a risk. A pertinent question for policy makers therefore is how to resolve such crisis in a way that would minimize the costs to the economy and the risks of such crisis recurring in the future.*

## **Reforming the banking sector- challenges and opportunities for transition countries**

The institutional capacity of banks in transition economies improves faster when a new or parallel private banking system is allowed to emerge than it does when the government tries simply to reform existing state-owned banks. Banking reform should stress decentralized institution-building and penalties for weak banks. In reforming the financial sector in transition economies, one important debate is about whether governments should try to reform existing state-owned banks - the rehabilitation approach - or whether a new private banking system should be allowed to emerge - a new entry approach. Or should there be a mix of the two approaches, in which the activities of state banks are restricted while a parallel private banking system develops?

A country comparison of banks' institutional development in 25 transition economies suggests that progress can be faster under the new entry approach, especially relative to initial conditions. Progress under the rehabilitation approach appears to be inhibited by poor incentives. In most countries, even those with a good banking infrastructure and a large segment of good banks, a two-track process has evolved, with large and growing differences between weak and strong banks. Whatever the banking reform approach taken, weak banks have moved very little beyond central planning.

Regression estimates suggest that in transition economies three things are associated with slow progress of weak banks: overconcentration, preferential treatment by governments, and limited entry for new banks. The direction of causality is often unclear. Policies and structural conditions can affect bank quality, but whenever a banking system has a certain quality, particular policies may also arise or structures exist.

The role of banks will remain limited in many transition economies because of weak legal infrastructures, much uncertainty and inside information, and problems

associated with highly leveraged financial intermediaries - including fraud, political interference, and implicit guarantees. In the short run, self-finance and intermediation among enterprises and through nonbank financial institutions may prevail. Current issues in banking policy range from the need to construct basic institutions and incentive structures in transition economies - to the challenges posed by the increasingly complex interactions involved in contemporary banking. Dissatisfaction with the diminishing effectiveness of postwar banking regulation led to substantial deregulation. Before adjusting to deregulation, bankers seemed vulnerable to a contagious euphoria, often manifested in overlending to property developers. Given the historic recurrence of carbon-copy banking failures, clearly private learning will not end all bank failure. And the disappointing performance of both regulated and unregulated financial sectors leaves a vacuum that theoreticians have been trying to fill. Theoreticians note that banking increasingly displays network characteristics that, on the one hand, may call for corrective action but that, on the other, make policy intervention ineffective or counterproductive. For one thing, networks are susceptible to externalities, redundancy (ensuring that flows cannot be obstructed by blocking just one path), and a tendency to adapt to disturbances in a complex manner. Regulation is justified, but the complexity of the network makes successful interventions hard to design. Supervision has an important role, among the basic regulatory measures needed. But the blurring of boundaries between banking and the rest of the financial network has placed an upper bound on the effectiveness of supervision.

### **An overview on the Romanian banking sector**

The financial problems of banks over the years have affected the whole banking sector and have shaken public confidence in banks. In many cases, people have lost money deposited or invested. On the other hand, bankers, say that no bank in the world, no matter how solid could withstand a mass panic of depositors rushing to



withdraw their money. However, nobody rushes to withdraw their money if everything is all right, and the panics which led banks to insolvency were not foundation. In Romania, problems occurred because national bank did not supervise banking practices properly. In addition, the legislation on bankruptcy delayed central bank from initiating bankruptcy procedures.

In the light of the financial system's crucial role in a functioning market economy, the banking market represents a key area in Romania's ongoing transition process. The country's upcoming EU membership in 2007 has set the tone for the banking sector's future development.

Unlike other transition countries in Central and Eastern Europe, Romania commenced fairly late with the reform of its banking system- a process that has been anything but smooth. The side effects of the transition to a market-oriented banking system (e.g. unstable macroeconomic environment, inefficient regulatory and supervisory norms, lax accounting standards, inadequate definition of property rights, soft budget constraints in the banking and enterprise sector, poor qualification of banks' lending decisions) led in the 1990's to a severely undercapitalized sector, an extensive bad debt problem and a lack of market discipline on the part of banks (moral hazard). This produced a banking crisis that dragged on for years, accompanied by the collapse of numerous banks, an investment fund sector crisis and a related crisis in the credit co-operative sector in 2000.

Cleaning up the banking sector was a costly and time-consuming process. Non-prudential practices by several banks came to light as the NBR adopted a more decisive attitude with regard to supervising banks, enacting stricter legal requirements and taking a more restrictive approach to monetary policy in the late 1990s. Romania's two largest state-owned banks, Bancorex and Banca Agricola, were prime examples of the problem of non-performing loans. In the view of the "too big to fail" problem authorities made several attempts to bail out and restructure these banks, with total fiscal costs reaching some USD 3bn (Bancorex: USD 2.4 bn,

Banca Agricola: USD 653 mn) or 8.3% of average 1991-2002 GDP. The authorities' efforts to rescue Bancorex eventually failed, but Banca Agricola was successfully restructured and privatized. Further restructuring measures, the closure of insolvent banks (e.g Banca Albina, Bankcoop), numerous successes in bank privatization (e.g. BRD, Banc Post) and the stepped-up presence of foreign banks enabled Romania's banking market to leave the heritage of centrally-planned economy behind; supported by economic stability that has been firmly in place since 2000, the sector embarked on a steady growth path. Indeed, significant structural changes in recent years give rise to expectations of an accelerated consolidation of the sector.

The root causes for the difficulties faced by these banks were the following: improper activities performed in previous years by managers, Board members and auditors, conducting of risky policies to attract an ever-growing volume of resources by offering high interest rates (most notably on household deposits) and investing them largely in credits to companies in poor financial and economic conditions, or practising connected lending. Therefore, banks could not recover credits and collect interest, entailing the steady deterioration of profitability, liquidity, and solvency ratios. The above mentioned problems were associated, with the dismal performance of the real sector, the main beneficiary of credits extended by majority domestic capital banks.

### **Recent contribution to banking development**

Similar to other transition countries Romania's banking system saw the number of commercial banks mushroom in the early phase of the transition process, with a nine-fold increase from only five in 1989 to 45 banks nine years, later, as result of the liberalization of market entry and lax licensing requirements. After weathering the financial and banking crisis in the late 1990s and subsequently initiating the process of bank restructuring, the sector began to consolidate, with the number of banks failing gradually to 38 at year-end 2003. One year later the Romanian banking

system comprised 39 banks (including seven foreign bank branches). This increase by one bank in comparison with 2003 resulted from the market entry of the two specialized banks. Porsche Bank Romania (vehicle financing) and Raiffeisen Banca pentru Locuinte (real estate financing) , and the merger of two small-scale banks, marking a reversal of the downward trend in the total number of banks that had been ongoing since 1999. The same holds true for the number of banks branches and bank employees, both of which initially decreased sharply as a result of restructuring measures taken in the years 1999 and 2000. However, banks' recent expansionary business strategy given the fierce competition for market share and their higher risk appetite which has generated increased lending activity, appear to be reflected in an expanding branch network and rising staff numbers. With the number of banks' branches reaching 2,921 per year – end 2003, i.e 7,500 inhabitants per branch (EU-15:2,060), however, Romania's banking market is still highly unsaturated, indicating significant catch-up potential.

Despite progress in catching up in recent years, Romania's banking market can still be considered underdeveloped, not only in comparison with the EU-15, but also its CEE peers. With only some 40% of the population aged 15 or older having some kind of business relationship with a bank card, as of year-end 2004 market penetration of banking services was still low.

This underdevelopment is also reflected in the banking sector's main efficiency indicators. Positive developments notwithstanding, there is still considerable room for further progress. At 38.3% in 2004, financial intermediation (the banking sector's total assets to GDP) remains low. Declining financial intermediation over many years was indeed a sign that the banking sector's development was lagging considerably behind macroeconomic expansion. Overcoming the banking crisis, successes in bank restructuring and privatization and the buoyant domestic demand-driven revival in lending all supported the banking market's impressive recovery in recent years. Nevertheless, in terms of financial intermediation, Romania

considerably trails its Central and Eastern European peers (e.g. Poland: 65.5% Hungary: 82.4%, Slovak Republic: 87.7%, Czech Republic: 96.1%, Croatia: 108.9%), not to mention the euro area (206%).

Likewise, by international comparison the ratio of private sector loans to GDP is relatively low in Romania, totaling a mere 17.5% as of end 2004 (e.g. Poland 30%, Czech Republic 33%, Hungary 42%, Croatia 62%, Euro area 102%). This low level can be attributed primarily to restructuring effects, as well as to the very cautious approach of banks to lending in the first years after the banking crisis.

Consolidation measures taken (e.g. closure of insolvent banks, portfolio clean-up via the transfer of bad loans from the banks' balance sheets to the Bank Asset Recovery Agency –AVAB), combined with an improved regulatory framework and better risk management on the part of banks, resulted in an impressive decline in the share of non-performing loans in the total loan portfolio from 58.5 % in 1998 to 2.8% in 2002. The introduction of stricter loan classification and provisioning requirements at the beginning of 2003, however, touched off a renewed increase in the ratio of non-performing loans in total lending to some 8.1% as of year-end 2004. To raise the efficiency of credit checks and further reduce the share of nonperforming loans, the National Bank of Romania (NBR) established a Credit Risk Bureau (CRB) in 2000, which delivers information on potential borrowers' credit and repayment track record. After four years of operation the NBR issued a new regulation on the CRB's organization and functioning, which entered into force on 1 September 2004. Since then, in order to further increase efficiency, credit information on non-resident legal entities must also be reported to the NBR. Furthermore, reporting has been extended to loans below the previously required RON 20,000 threshold. Considering the current rapid pace of credit growth, this is an important step toward preventing deterioration in loan portfolio quality.

## **Lessons from other banking crisis to be applied in other transition economies**

Comparing the banking crises experienced in Estonia, Latvia, and Lithuania by causes, effects, and policy responses we may find interesting conclusions.

The starting point for the three banking systems was the same: They inherited the monobank system of the former Soviet Union, with specialized state banks serving specific branches of the economy. They quickly established a central bank at the core of their banking system. They were weak in bank management and lacked staffs with modern banking skills, and no system had an appropriate legal, regulatory, or supervisory framework governing the banks. In some instances fraud and corruption prevailed, encouraged by the relatively permissive regulatory and supervisory environment for banks that existed in the Baltics. All had to decide what to do with the remnants of the Soviet banking system at the same time that they encouraged the growth of the new private banking sector.

Estonia and Lithuania reconstituted the specialized Soviet banks as national state banks and began to privatize them. In some instances the state retains an ownership stake. In Lithuania the state may increase its ownership share as part of a rescue effort for some former state banks. Latvia, by contrast, reconstituted the savings bank, then privatized branches of the remaining banks. The residual branches were merged into one bank, rehabilitated, and then subject to formal privatization. The savings bank is now being privatized. In fact, in the spring of 1995, Latvia experienced the largest banking crisis in the former Soviet Union to date, involving the loss of about 40 percent of the banking system's assets and liabilities

In the early stages the three private banking systems were similar and grew rapidly. All three have had liberal policies toward licensing new commercial banks, believing that more banks would generate the competition needed to drive down deposit and lending rates, and provide the capital needed to support the emerging

private sector. Many new private banks were established by enterprises that wanted access to cheaper funding than was available from other banks. Little thought was given at first to the implications of this policy for banking safety and supervision.

he main lessons to be learnt by other countries could be summarized as follows:

- Banking systems are exposed to stress in several major ways. Enterprises -the main borrowers - become subject to hard budget constraints (are cut off from government funds) and are privatized. Inflation declines so enterprises can't rely on rapidly increasing revenues to service bank debts. Economic reform tends to produce banking systems that are mainly privately owned -making them vulnerable to withdrawals, as the public does not assume that failing banks will be bailed out.
- The government must protect against this vulnerability by establishing a proper legal framework for banking, developing effective bank supervision and regulation, and implementing solid accounting, disclosure, and auditing standards. It must also develop effective ways to handle problem banks and to close insolvent banks promptly.
- For banks in the state sector to be a source of strength to the banking system, they must have strong effective management and be relatively free from political influence.
- "Outlier" banks - those expanding assets very quickly or offering particularly high deposit rates -should be subject to intense supervision.
- Four things must be done to prevent fraud, incompetent management, and excessive risk-taking: carefully screen those who want to get into banking; subject all banks to thorough, frequent onsite examinations and assign the best examiners to the largest banks; require annual audits of all banks by reputable auditing firms required to report significant irregularities to authorities; and act decisively when fraud or bank difficulties are detected or suspected.

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# THE IMPACT OF INTERNATIONAL INVESTMENT FLOWS VOLATILITY UPON HOST COUNTRIES ECONOMIC GROWTH

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*Foreign investments are considered to be essential in generating economic growth due mainly to the completion of national capital, creation and development of connections between foreign investors and local firms, generating growth of private sector competitiveness, improvement of local skills and assuring technology transfer. The forms in which foreign investments may enter in a national economy can be multifarious as well as the effects they generate. While some specialists are pointing out the positive effects of international investments, some of them criticize their negative impacts on host economies. One of these negative impacts is considered to be the volatility of international investment flows.*

*In order to diminish the negative impact of international investment flows volatility, countries may include in international agreements assurance schemes or decisional factors from host economy must generate, in the first place, through regulatory measures, economical and political stability that will assure foreign investors the background needed to feel safe to invest in that economy, and secondly these measure will reduce the negative impact of volatility on host economy.*

The essential role of foreign direct investments in assuring economic growth is already well established. But one cannot diminish the fact that foreign direct investments can generate negative effects upon host countries economies. While some specialists are pointing out the positive effects of foreign direct investments,



some of them criticize their crowding out effect upon national investments and the limitation of national space regarding regulatory standards.

Another negative effect of foreign direct investments derives from their volatility degree. A study realized in 2001 by Robert Lensink and Oliver Morrissey entitled "Flows, volatility and growth"<sup>1</sup> has shown that FDI have positive effect upon economic growth, while their volatility has a negative impact. They believe that there are many reasons why the FDI inflows volatility generates negative impact upon growth.

A first reason derives from the fact that the concept of volatility itself indicates uncertainty and negative impact upon growth.

Specialty literature shows that foreign direct investments have positive impact upon economic growth through cost reduction related to research and development activities and innovation stimulation.

Transnational corporations are probably the highest technological advanced firms worldwide. They do not only import efficient foreign technology through foreign direct investments but also generate its transfer in host economy. It is well known the fact that technological changes play a major and central role in economic growth and transnational corporation's foreign direct investments represents one of the main channels to transfer advanced technology into developing countries. The technology emission can be realized through *imitation*, *competition*, *firms' linkages* and *local personnel qualification*.

By *imitation* of advanced technology or foreign firm's managerial practices, local firms can become more productive. In foreign direct investments absence the procurement of necessary information needed in adoption of new technology implies costs far too high for local firms. Through *competition*, generated by entrance of

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<sup>1</sup> Robert Lensink and Oliver Morrissey, paper presented at The Development Economics Study Group Conference, University of Nottingham, Nottingham, 5-7 April 2001.

foreign firms on local markets, national firms are encouraged but also are liable for becoming more efficient by innovation of technological base. Moreover, by *linkage development and transactions with local firms*, foreign investors can accomplish new technology transfer, can provide technical assistance if these linkages become stronger. The *preparation phase* appears in the situation in which the use of new technology requires personnel higher qualification. The entrance of foreign can be an incentive for local firms to invest in its personnel qualification. A study realized by Aitken and Harrison in 1999 entitled <sup>2</sup>Do domestic firms benefits from direct foreign investments? reveals that the authors consider that can appear positive effects of propagation, or there are no effects or they are negative. We consider that there are no effects of propagation in case local firms` personnel are not qualified to assimilate new technology, and negative effects appear when local firms cannot face foreign firm`s competition and will be eliminate from the market.

So, if the foreign direct investments entrance flows are uncertain, than the costs of research and development activities are uncertain, which will affect in a negative way the innovation incentives.

A second reason would be the fact that foreign direct investments flows volatility reflects economical and political uncertainties and constitute their support through imbalances generated in host country economy. Lensink, Morrissey, Guillaumont and Chavet<sup>3</sup> in a study realized in 1999, indicated that economic uncertainty is an important determinant, in a negative way, for both investments growth and productivity. By economic uncertainty they refer to some developing economies tendency to be vulnerable at shocks (such as financial crisis or terms of trade generated by capital flows volatility or natural elements such as earthquake or

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<sup>2</sup> Aitken and Harrison, Do domestic firms benefits from direct foreign investments?, American Economic Review, 89, 605-618, 1999.

<sup>3</sup> Robert Lensink, Oliver Morrissey, Guillaumont and Chavet, Aid and performance: A Reassessment, CERDI< CNRS and University of Auvergne, 1999.

flooding) that generate income reduction and recurrent demand reduction or they constrain the ability of an economy to generate stable growth. While foreign direct investments tend to be less volatile than other flows, it is still possible that sudden changes in foreign direct investments entrance flows may have a destabilizing impact upon host country economy.

In this context we believe that the assurance system will play an important role in foreign direct investments flows volatility reduction (especially in case of those affected more strongly by economical and political uncertainties) in order to foreign investors, in substantiation of their investing decisions, will give a lower attention to economical and political uncertainties and will appreciate the opportunity of entering an economy mainly by economical determinants of that country. That's why we consider that the inclusion of assurance schemes in international investments agreements is essential in reduction of investment flows volatility.

Countries with high level of economic uncertainty have the tendency to generate slower rate of economic growth or more variable so, they can appear less attractive to foreign investors. It is a modality to explain volatility of foreign direct investment but, not all categories of foreign direct investments are equally influenced by economical and political uncertainties. In these situations also the role of assurance system is very important but, first of all, it is vital for host countries to assure a stable economic growth so they won't be affected by foreign direct investment flows volatility.

As regards the portfolio investments we will appreciate their volatility starting with the definition of these category or international investments. We consider that portfolio investments represents capitals transfers, usually on short term (but not necessary) with the single purpose of purchasing financial assets in order to obtain financial annuities (dividends, interests, gain from arbitrations operations, etc.)

characterized by volatility and strong speculative connotation. The portfolio investments flows are directly linked to the development of stock exchanges as the investors are interested in the possibility of realizing investments in financial instruments that can assure higher financial gains than other financial markets. So, the portfolio investors are firstly interested in obtaining high financial earns due to their investments or ventures done, and they will invest mainly in developed countries rather than in developing one.

In this order, the volatility of portfolio investments is a second nature of these types of investments as shown before. In order to compare the volatility of these two types of international investments we will take into account the following elements:

1. interests and motivations – portfolio investors are interested mainly in developed countries financial markets because those assure higher profits, while direct investments are realized with the purpose of establishing, proceeding and consolidating productive assets in host countries; even though both of them pursue the financial gains, the lasting interest in management and linkages with local firms, specific to foreign direct investments, make them less volatile than the portfolio one;
2. types – portfolio investors are, usually, financial institutions, pension funds, assurance societies or investments funds while foreign direct investments are firms engaged in merchandises and services productions;
3. time implication horizon – portfolio investments time implication horizon is, due to their speculative character, more reduced than in case of foreign direct investments who, due to their specific and palpable means of achievement, implies a long lasting relationship of foreign investor in host economy (making them less volatile than the portfolio ones);

4. factors that influence them – usually, foreign direct investments are located taking into account several specific criteria: *location* that assure the lowest or lower production costs, *regulatory standards* more permissible, higher *economic growth rate*, *larger markets*, etc.; moreover, we must realize a more profound and nuanced analysis referring to different categories of foreign direct investments and factors that determine foreign direct investments (for example, efficiency or asset seeking foreign investors are less interested by the potential or the actual rate growth, such as those direct investments made in order to rationalize production or establish an export oriented production; in their case, they may be more interested in the cost, qualification and aptitudes of employers, material and telecommunication infrastructure, geographical location, distance to target markets, the existence of free trade agreements between host country and target market that can facilitate trade and market accession, etc. ); portfolio investors are located on those markets that assure a better or the best fructifying possibilities for invested capitals; for them currency regulations, the facility in repatriating companies capitals that operate on local markets, tax systems are extremely important while foreign direct investors do not find them extremely important.

We can conclude that foreign direct investments are less volatile than portfolio investments. If we take into account the fact that foreign direct investments generate more positive effects and implications far more important on host economy than portfolio investments it is obvious why, at international level, different organisms having international vocation (such as World Bank or OECD) are trying to establish a demarcation line between these two forms of international investments and why, al

national level, countries and governments are regarding foreign direct investments more favorable than portfolio investments.

Another conclusion that arises is that of necessity of assuring systems which can, as we shown before, reduce the volatility of international investments flows. In order to be used the assuring schemes must be a part of international agreements related to international investments. But, at international level, even though there are many regional and bilateral agreements, very few of them have references related to assurance because they are being negotiated and countries yet do not find them very important. The accent is on economic determinants considered by foreign investors the most important factor that influences the magnitude and evolution of foreign direct investments and financial market development for portfolio investments.

Another conclusion that can be pointed out is that the volatility of international investments flows is influenced by national regulatory standards in which the governments play a major role, firstly in assuring macroeconomic stability, through economical and political measures, that can make foreign investors feel safe and secondly by establishing measures that can reduce the negative impact of their volatility.

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## **MARKETING METHODS APPLIED TO THE STUDY OF ROMANIAN INSURANCE MARKET**

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*In Romania, the insurance market is in full swing both quantitatively and qualitatively and competition has been increasing. The study of insurance market involves the analysis of both insurance demand and supply, the market organization according target customers, as well as evaluation of market size, which can be performed through application of market methods. We consider that pertinent information about the insurance market can be successfully obtained through surveys that employ the questionnaire as a basic research instrument.*

The interest for the profound study of the insurance market in Romania was the foundation in the elaboration of this material, which we consider a beginning in a series of many more works that we would like to communicate.



We started from the idea that on a competitive market each company from the insurance area has to offer what is requested. But for this you have to know the needs, the desires of the potentials and of the currently insured people, it is necessary the analysis of the factors that start and affect the insurance demand. We consider that these objectives can be achieved by applying different methods, techniques, instruments and recognized procedures of marketing.

### **1. The defining elements of the insurance market**

The risk's protection is considered by more and more specialists a service that is sold and bought on a specific market, called *the insurance and reinsurance market*. It is a part of *the financial services market*.

Because the economic theory defines **the market** as being “the sphere of manifestation and confrontation between the offer and demand, of their achievement through the purchasing/ selling papers”<sup>1</sup>, we consider that to study the insurance market it is opportune and necessary the presentation of some defining elements for it, like the insurance offer and request.

**The insurance request** is based on the manifested needs of physical and judicial persons that face different insurable risks. They wish to insure themselves and have the financial possibility of supporting the insurance's cost.

If, generally, the request for a usual product is influenced by the income of the consumers, by the price of that particularly product, by its quality, by the price of some replaceable products, we appreciate that the size, structure and evolution of the insurance request are influenced, mainly, by these **factors**:

- **objectives**: demographics ( size of population, sex, age, families structure, ethnic characteristics, the geographic movements of the population etc.); socials; economics (

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<sup>1</sup> V. Balaure (coord.), V. Adăscăliței, Carmen Bălan, Șt. Bboc, I. Cătoiu, V. Olteanu, N. Al. Pop, N. Teodorescu - *Marketing*, ediția a 2-a, editura Uranus, București, 2002, pag. 83

the acquisition power of potential insured people, the level of insurance premium<sup>2</sup>); legislatives(legislatives conditions, facilities offered on a legal and financial plan) etc.

- **subjective**, like the need of insurance and the degree of realizing this, the convictions of potentials insured people considering the utility of the insurance etc.

We appreciate that in our country the main bearers of the insurance demand are: economy agents, public institutions, organizations without work purpose and the population.

If the services offer expresses “the production” of services inside the market<sup>3</sup>, than we can consider **the insurance offer** like being “the production” of insurance products destined to be commercialized on the market. This offer is promoted in our country by specialized companies (of insurance and insurance-reinsurance), licensed to work in these area, which need to have the ability to face the obligations of payment to their clients.

On the international market of insurances, the insurance offer may be promoted by other operators, like: reinsurance companies, captive companies of insurances and/or reinsurances, mutual organizations of insurance, Lloyd’s organizations, insurances and reinsurances pool’s.

## **2. The dimensions of the insurances market and pointers used in her analyzation from the marketing perspective**

Ph. Kotler shows that the market is “the ensemble of the buyers and the sellers who are interested or could be interested in the trade of a good or a service”<sup>4</sup>.

This term is used in different contexts, such as:

- the needs market ( the shoe market, the sport market, the insurance market etc);
- the demographic market ( the teenagers market, the elders market etc);

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<sup>2</sup> D. Badea, Luminița Ionescu, *Asigurările de persoane și reflectarea lor în contabilitate*, editura Economică, București, 2001, pag. 17

<sup>3</sup> Iuliana Cetină, V. Olteanu - *Marketingul serviciilor*, coediție Marketer-Expert, București, 1994, pag.51

<sup>4</sup> Loredana Răhău, *Marketing*, editura Dimitrie Cantemir, Tîrgu Mureș, 2003, pag. 57

- the geographic market (Romania's market, Germany's market, Europe's market, London's market etc.);

- the product's market (the cosmetics market, the flowers market, the medical insurance market etc.).

If we make direct reference to the insurance market, the specialists delimitate and suggest the usage of some terms like<sup>5</sup>:

- *the effective market of insurances*, that reflects "the needs of the present consumers of the insurance company"<sup>6</sup> and *the potential insurance market*, which reflects "the possible size of the insurances market"<sup>7</sup>. It includes the group of consumers which characterize themselves through a level of interest big enough for an offer given by the insurances.<sup>8</sup>

- *the market of the insurance companies*, that represents the proportion in which the products of a certain insurance company have penetrated the consumption and *the market of the insurance product*, which considers the penetration degree in consumption of a certain type of insurance.

- *the intern market of insurances*, regarding the offer and demand of insurances manifested on the Romanian territory, for example, and *the international market of insurances*, that is the offer and demand of insurances that go beyond a country's territory;

- *the market of sellers and the market of buyers of insurances*;

- *the target market*, meaning the segment to which the seller of insurances orientates his entire mix of marketing etc.

In order to be able to evolve an efficient activity, an insurance company must know the market in which she operates.

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<sup>5</sup> Eva Cristina Petrescu, *Marketing în asigurări*, editura Uranus, București, 2005, pag. 84-86

<sup>6</sup> Virgil Balaure (coord.), *op. cit.*, pag. 95

<sup>7</sup> Ibidem, pag. 95-96

<sup>8</sup> Ph. Kotler, *Managementul marketingului*, editura Teora, București, 1998, pag. 323

For the **analysis of the insurances market** you can use a series of **pointers**, among which the most important are: the volume of the insurance premium received from the insured people, the degree of penetration of the insurances in the economy, the insurance's density, the volume of the paid damages, the damage's installment, the number of concluded contracts on the market in the period of reference, the number of active policies, the number and the size of the insurance companies on the market, the number of employees in the insurance area, the market quotation of the insurance companies, the installment of the increase of the market etc.

Each of these pointers we consider very useful, with major significance, but we will stop over those which are used by the marketing man when he studies the market. Now the studied market is the insurance market, and the pointers advised to be followed are:

- **the volume of the gross premium received from the insured people**, that present the real size of the insurance market in a certain moment;
- **the penetration degree of the insurances in the economy**, that presents the contribution of the insurances domain at the gross domestic product (GDP) creation;
- **the insurance contracts number signed in the reference period**, that shows the size of the satisfied demand on the market;
- **the number of the insurance companies**, which is important for the insurance offer;
- **the market's quota of the insurance companies**, that show the market position of different insurance companies and that allows us to observe if the market is concentrated or not;
- **the installment of the market's development**, that indicates the rhythm of development of the insurances market and if the market is in a slow development, stagnation or decrease<sup>9</sup>.

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<sup>9</sup> Rata (ritmul) de creștere a pieței (RCP) se calculează cu formula: 
$$RCP = \frac{V_T(t+1) - V_T(t)}{V_T(t)} \times 100$$

For example, to measure the capacity of an insurance company in a certain period of time you can use different pointers, like: the sales volume of the insurance company, the market quota, the relative market quota, etc. More clearly:

- **the sales volume of the insurance company** can be express through the *insurance premium volume received from the insured people* and through *the number of insurance contracts signed in the reference period*. The sales volume of the insurance company is the pointer that can be used to measure the size of the effective market and to predict, with a certain probability, the size of the potential market;

- **the market quota** is the percentual expression of the sales of an insurance company toward the total sales registered on the market that it is effective present.

Because not all the modification of the market quota are significant for a company's development (a price reduction can lead to an increase of the market quota, but only temporary), **Ph. Kotler** introduced the analysis of the market's quota variations according to 4 components: the customers penetration installment, the customers faithfulness installment, the customers selection (the selection coefficient) and the price selection (the price adjustment coefficient)<sup>10</sup>. Such as:

-  $R_{pX}$  is the customer penetration installment for the X Company and it is the percentual report between the number of customers of the X Company and the total number of customers on the market;

-  $R_{fX}$  is the customers faithfulness installment for the X company and it can be obtain by dividing the report between the purchase papers made in the X company and the number of customers for the X company at the report between the total number of purchased papers on the market and the total numbers of customers on the market;

-  $C_{sX}$  is the selectivity coefficient for the X Company and represents the report between the medium volume of purchases made by the customers of the X Company and the medium volume of purchases on the market

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unde:  $V_T(t+1)$  reprezintă vânzări totale existente pe piață la momentul "t+1";  
 $V_T(T)$  sunt vânzări totale de pe piață la momentul "t".

<sup>10</sup> Ph. Kotler, *op. cit.*, pag. 951

-  $C_{apX}$  is the coefficient of the prices adjustment for the X Company and it is obtain from the report between the price practiced by the X Company and the medium price on the market.

**Kotler's formula** becomes:

$$C_{PX(\%)} = R_{pX} \times R_{fX} \times C_{sX} \times C_{apX},$$

### **3. Appreciations contracted by studying the insurance market from Romania**

The insurance market in Romania is in development. **The insurance demand** on the Romanian market does not have a uniform character concerning the requested type of insurances, not even concerning the geographical distribution. It is focused on the geographical areas with a lifted economic performance and on the population with over the medium incomes.

*The potential demand of insurances* is lifted because of the lifted number of people, properties, unsatisfied needs of the physic and judicial persons.

*The effective demand* is pretty low. It can be explained both through reasons of economic order (the low incomes of the population, the absence of the financial support), and through the absence of an education in these area of the potential insured people.

The interest relative low towards the contractation of insurance can be a consequence of not understanding the role and necessity of the insurances, of the existence of a long period in which the population was accustomed with a “free” guarantee of the damage by the state. Now, the role of the insurance companies is to create a new conception, the companies having an informative role, but also educative.

If by 2000 the insurance offer was considered as “limited and less adapted at the market needs, less flexible, not existing a developed system of the financial services (credits, mortgages)” because of “the deficitary infra-structure, of the heavy and

uncomfortable payment system, because of the lack of comfortable payment instruments for the customers”<sup>11</sup>.

Now the situation changed. The offer on the insurance market is characterized by a diversifying tendency of the insurance products palette, an important number of new products appearing on the market adjusted to the specific needs of the Romanian market. The companies that bring great novelties on the market are those with foreign capital.

We can also say that the Romanian market of insurances is a competitive market. The number of insurance companies grew from 4 in 1991, to 73 companies in 1999, but most of them were under-capitalized, and the security degree was pointed by their financial capacity.

The *nr. 32/2000 Law concerning the insurance companies and the insurances supervision* tried to correct this under-capitalization phenomenon by the fact that it provides a minimum social capital both for general insurances and for life insurances. So, by the end of the year 2004, there were registered at CSA 44 insurance companies, from which worked 42. All though there are a great number of insurance companies, most of the activity on the market is carried on by a limited number of firms: the first 10 companies on the market accomplished over 80% of the insurance premium.

Even if the interest to contract an insurance stays pretty low, we can observe from the evolution of receivements from gross premium that the Romania’s insurance market is in development (to be seen in Table 1).

The fact that the insurance market is a market in development can be also proved through the favorable evolution of the penetration degree of insurances in economy.

The penetration degree of insurances in economy in Romania has know a slow development (see Table 2), but constant, arriving in 2004 at 1,36%, regarding 1,28% in 2003. All though in development regarding the past years, the insurances penetration

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<sup>11</sup> Violeta Ciurel, *Asigurări și reasigurări: abordări teoretice și practici internaționale*, editura All Beck, București, 2000, pag. 16

degree in Romania still stays at a low level comparing to the values registered in states from the European Union.

**Table 1. The evolution of gross premium received from direct insurances contracts in 1997-2004**

<b>Year</b>	<b>The volum of the gross premium received (bil. lei)</b>	<b>Nominal increase refering to the past year (%)</b>	<b>Real increase (%)</b>	<b>The inflation instalement (%)</b>
1997	1.304.1	137.05	-	151,4
1998	2.414.8	85.18	31,71	40,6
1999	4.273.9	76.99	14,33	54,8
2000	6.738,9	57,67	12,06	40,7
2001	10.012,4	48,58	14,03	30,3
2002	16.459,7	64,39	39,55	17,8
2003	24.225,1	47,18	28,99	14,1
2004	32.163,9	32,77	21,47	9,3

Source: Annual reports of OSAAR, ASAAR, CSA for 1998 - 2004

Today the insurance market from Romania can be characterized so: a market with a competition in development, a market in development both quantitatively and qualitatively, with a demand focused in the areas with an economic activity above medium.

A positive tendency on this market is to diversify the offer, by introducing some new products, adjusted to the needs of the customers- an important role in this sense being owned by the companies with a foreign capital, whose penetration on the market



determined the increase of the qualitative level of services and the offer of some products similar to those from the international market.

The development of the insurances market in Romania depends mostly on the development of the standard of living, the acquisition power, but it also depends on the way that the potential insured people are informed and educated.

An important contribution in this sense is hold by the traditional ways of information: news-papers (the most important news-papers having special pages dedicated to the insurances), and modern ways (the internet – the CSA webpage: [www.csa-isc.ro](http://www.csa-isc.ro), the sites of the insurance companies, the site: [www.lasig.ro](http://www.lasig.ro)), that provides a greater transparency of the market.

**Table 2. The insurance penetration degree in 1997-2004**

<b>Year</b>	<b>Gross received premium (bil. lei)</b>	<b>PIB (mii mld. lei)</b>	<b>Penetration degree (%)</b>
1997	1.304.1	252,9	0,53
1998	2.414.8	373,8	0,70
1999	4.273.9	545,7	0,79
2000	6.738,9	803,8	0,85
2001	10.012,4	1.154,1	0,87
2002	16.459,7	1.512,3	1,09
2003	24.225,1	1.890,8	1,28
2004	32.163,9	2.387,9	1,36

Source: Annual reports of OSAAR, ASAAR, CSA for 1998 - 2004

In conclusion, it can be said that the insurance market from Romania has had a positive evolution: the portfolio of the insurance companies has diversified, the incomes from the insurances premium have risen, the territorial area in which the insurance companies develop their activity has been extended, the degree of security of the market has grown.

The size, the structure and the evolution of the insurances market depend on the interest of potential insured people on the insurance, the interest of the insurance companies regarding the promotion of different forms of insurance, and also on the environment's conditions in which these develop their activity.

The evolution of the insurance market in Romania is tied to the changes that take place in the economy, political and social environment. In this context a really important role is given to the state, which through its social and economic politics can influence the evolution of the insurance area.

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## NET LIQUIDATION ASSET

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*This value is determined when the company is thought to cease its activity. The basis for asset valuating according to the evaluation standards is liquidation value. The liquidation value concept must be interpreted according to the way the company cease its activity i.e. through progressive or immediate liquidation. In the first case the asset value will be estimated at their market value and in the second one at their liquidation value. Net liquidation value can be obtained by the following mathematic – economic formula.*

$$NLV = NAV + RD1 - RD2 - LC - A$$

*NLV = net liquidation asset/value NAV = net asset value RD1 = positive adjusted differences after revaluation (adjustments) RD2 = negative differences after revaluation A = appreciation/capital gains tax*

In case of activity termination, the value of the companies is estimated based on the net liquidation value of the assets. In this case the basis for asset valuation is the **liquidation value, a value** which is also recommended in the evaluation standards in the case of company liquidation.

Net liquidation asset value is an interest especially for the company's shareholders and associates, the company's manager, banks or other credit institutions, suppliers, other creditors, liquidators, and so on, in case of forced liquidation or if it happens that the company is at a loss a longer period of time and

following the provisions it did not result any recovery of the company (loss, insolvability so on). If it happens that the net liquidation asset has a higher value than the estimated value on a profitability base it is recommended the association, the merger, or even the liquidation of the company.

The concept of liquidation value must be viewed taking into consideration the solution for the activity termination, namely **progressive liquidation** or **immediate liquidation**.

In the case of progressive liquidation, the liquidation value is equal to the market value, due to the conditions and timeframe allocated to this process. This type of liquidation type is known also as arranged liquidation because it is done within a reasonable timeframe (the debts do not become eligible immediately so they don't have to be paid immediately) in order to get the best price for the assets, which are sold in order to pay the debts of the company and to distribute the remaining value of the assets between the shareholders or associates. Net liquidation asset value is obtained by diminishing the valued assets in market conditions (sometimes this values are lower than the booking value) with the booking value of the debts.

**Liquidation net asset = Market value of the assets – Booking value of the due debts**

In the case of immediate liquidation, the liquidation value is considered to be a special form of the market value, because of the special conditions of selling the assets, the timeframe allocated for selling, inappropriate market exposure and publicity, compared with the necessary time and promotional measures for obtaining the best price on the market. In this case the owner is forced to sell.

The Standard IVS 2, Different Valuation basis besides market value, defines the liquidation value as the amount of money that can be obtained reasonably from selling an asset within a timeframe too short to fulfill all the conditions for market value definition. The standard also says that the price associated with a forced selling is not the market price. This price is a reality and it is difficult to predict because of the nature and coverage of the subjective and conjectural which have to be stated.

In the case of liquidation the assets can be sold piece by piece, partially by piece or as a whole, and this phenomenon must be taken into consideration by the valuator in the valuing report.

**Net Liquidation Asset (NLA) = Valuated assets based on the liquidation value (TA) – Balance Sheet Debts (BD)– Other debts from the liquidation balance sheet (OD) – Liquidation Costs (LC)**

**Where:**

- Other debts from the liquidation balance sheet will be posted into the books;
- Liquidation costs, comprise generally activity support costs during the liquidation period, personal lay-off costs, penalties for anticipated loan return or leasing contracts breach, liquidators fees, advertising, asset conservation costs, selling commissions.

The documentation for establishing the liquidation net asset comprises of inventory lists, accounting balance sheet, liquidation starting balance sheet, liquidation final balance sheet. Based on the balance sheet and the inventory for the liquidation the liquidation starting balance is done. The inventory value is usually estimated by an expert valuator, which has to conduct the evaluation process according to the accounting regulations for inventories. Assets utility for the company is in this case not important, only the market price is interesting. We can adjust this price with some corrections due especially to the limited timeframe for selling, limited advertising and the known condition of the company for the buyers. The corrections level are appreciated by a valuator and are between 0% and 50%. Among the most important accounting operations in the balance sheet for starting the liquidation are as follows:

- a) *Elimination from the balance sheet assets of the assets considered without economical value* in the case of liquidation (foundation costs, considering that liquidation is a process developed after dissolving the company, and its purpose is erasing the company from commercial register, development

costs in the case of inexistent buyer for the results of the research, goodwill when it is decided to sell the assets separately);

- b) *Reactivation of cost posted in advance*, costs relate to future periods because the present period is considered the last one of the company;
- c) *Transfer to revenues*, of the subsidies received and not posted as results, of provisions for depreciation and for risks and spending existent at the moment of liquidation;
- d) *Transfer to liabilities* of the revenue posted in advance, considering that the current period is the last one of the company;

Specific operations for liquidation are usually done by liquidators. The valuator's presence in the liquidation team is necessary considering that the value is after all an opinion, raised by an individual based on its own judgment. This opinion is as more credible as the valuator is more qualified in this area.

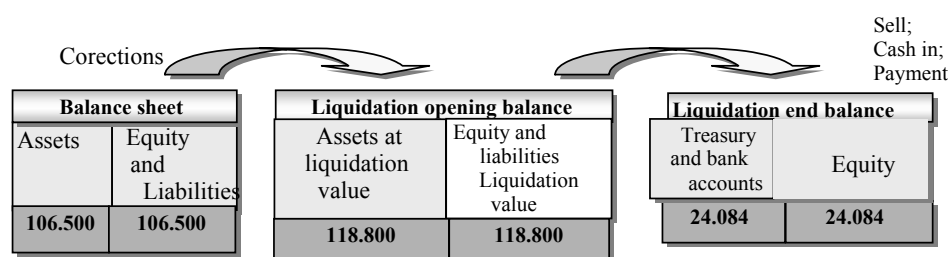


Fig. 1.- Necessary steps for liquidation end balance

As a demonstration we will present the calculation steps and the method for liquidation end balance realization for company “X”. In column 1, the data presented is the data from the last balance sheet of the company. Liquidation value, estimated by the expert valuator, of the Company's assets and liabilities are shown in column 3, considering the market value and the corrections applied by the expert valuator. These values can be confirmed by the market or denied by the market when major differences are encountered.

Balance Sheet Object	Balance Sheet Value	Market Value ( $V_p$ )	Liquidation Value ( $V_l$ )	Correction applied absolute value $\Delta_{V_p/V_l}$	Correction applied relative value $I_{V_p/V_l}^A$
Land	20.000	35.000	30.000	-5.000	-14,2857
Constructions	30.000	45.000	40.000	-5.000	-11,1111

<b>Technological Equipment etc.</b>	<b>10.000</b>	<b>11.000</b>	<b>8.000</b>	<b>-3.000</b>	<b>-27,2727</b>
<b>Furniture etc.</b>	<b>5000</b>	<b>4000</b>	<b>3000</b>	<b>-1.000</b>	<b>-25</b>
<b>Stocks</b>	<b>12.000</b>	<b>11.500</b>	<b>11.000</b>	<b>-500</b>	<b>-4,34783</b>

As far as raw materials are concerned, the extra value is the result of the inventory conducted by the expert valuator. A part of the goods in inventory, valuing 1000 m.u. are damaged and this is the reason the valuator has eliminated them. Liquidation costs, paid by bank transfer are in total of 200 m.u., and the liquidator's fee is in total of 500 m.u.

The liquidation end balance will reflect the amounts that will be divided by the shareholders or associates after selling, cashing in and payments.

ASSET	Row No.	m.u.				
		Accout. balance	Corection	Liquidat. Opening balance	Selling Cashing in Payment	Liquidat. End Balance
A		1	2	3	4	5
<b>A. FIXED ASSETS</b>						
<b>I) Intangible Assets</b>	<b>1</b>	<b>1.500</b>	<b>-700</b>	<b>800</b>		
Foundation and development cost	*	500	-500	0		
Goodwill	*	0	0	0		
Other intangible assets	*	1000	-200	800		
<i>Capitalization + provisions for depreciation of intangible assets.</i>	*	2000	0	0		
<b>II) Fixed Assets</b>	<b>2</b>	<b>65.000</b>	<b>16.000</b>	<b>81.000</b>	<b>84.800</b>	
Land	*	20000	10000	30000		
Constructions	*	30000	10000	40000		
<i>Capitalization +provisions for depreciation of constructions</i>	*	5000	0	0		
Technological equipment, Devices and measuring, control and regulation installations Transportation vehicles	*	10000	-2000	8000		
<i>Capitalization +provisions for depreciation of equipment</i>	*	5000	0	0		
Furniture, computing equipment, protection equipment and other fixed assets	*	5000	-2000	3000		
<i>Capitalization +provisions for depreciation of furniture</i>	*	2000	0	0		
<b>III) FINANCIAL ASSETS</b>	<b>3</b>	<b>2.000</b>	<b>1000</b>	<b>3.000</b>		
Provision for depreciation of fin.		0	0	0		



<b>FIXED ASSETS -TOTAL</b>	<b>4</b>	<b>68.500</b>	<b>16.300</b>	<b>84.800</b>		
<b>B. CURRENT ASETS</b>						
<b>I) INVENTORIES</b>	<b>5</b>	<b>12.000</b>	<b>-1000</b>	<b>11.000</b>	<b>11.000</b>	
Raw materials inventories		5000	1.000	6000		
Production in progress		0	0	0		
Products		4000	-1.000	3000		
Inventories at third parties		0	0	0		
Animals		0	0	0		
Goods		3000	-1.000	2000		
Packing materials		0	0	0		
<b>II) RECEIVABLES</b>	<b>6</b>	<b>12.000</b>	<b>-1.000</b>	<b>11.000</b>	<b>11.000</b>	
Suppliers-debtors		0	0	0		
Clients and other accounts		10000	-1.000	9000		
Other receivables		2000	0	2000		
<b>III) SHORT TERM FINANCIAL</b>	<b>7</b>	<b>0</b>	<b>0</b>	<b>0</b>		
<b>IV) TREASURY AND BANK ACCOUNTS</b>	<b>8</b>	<b>12.000</b>	<b>0</b>	<b>12.000</b>		
Bank Accounts in Lei		5000	0	5000		<b>24.084</b>
Bank accounts in different currencies		4000	0	4000		
Treasury in lei		3000	0	3000		
Treasury if currencies		0	0	0		
Letter of credit in lei		0	0			
Letter of credit in foreign currency		0	0			
Advances from the treasury			0			
Other values		0	0			
<b>CURRENT ASSETS –TOTAL</b>	<b>9</b>	<b>36.000</b>	<b>-2.000</b>	<b>34.000</b>		
<b>C. DIFFERED SPENDINGS (ct 471)</b>	<b>10</b>	<b>2.000</b>	<b>-2.000</b>	<b>0</b>		
<b>GRAND TOTAL- ASSETS</b>		<b>106.500</b>	<b>12.300</b>	<b>118.800</b>		
<b>D. LIABILITIES DUE IN LESS THEN A YEAR</b>	<b>11</b>					
		<b>72.000</b>	<b>2.716</b>	<b>74.716</b>	<b>74.716</b>	
Short term bank loans		20000	0	20000		
Interest to be paid		0	0	0		
Suppliers		20000	0	20000		
Clients – creditors		0	0	0		
Profit taxes		0	<b>2016</b>	<b>2016</b>		
Value Added Tax		0	0	0		
Other liabilities to the state and public institutions		2000		2000		
Personnel liabilities		5000		5000		
Groups and other accounts with associates		20000	700	20700		
Other creditors		5000		5000		
Other liabilities due in les then a year		<b>0</b>				

<b>E. LIABILITIES DUE IN MORE THEN A YEAR</b>	<b>14</b>					
		20000		20000	20000	
Loans from obligations issuing		20000		20000		
Long and medium term bank loans		0				
Long and medium term bank loans overdue		0	0	0		
Interest to be paid		0				
Other loans and financial liabilities		0				
Fixed assets suppliers		0				
Other liabilities due in more then a year						
<b>F. PROVISIONS FOR RISKS AND SPENDINGS</b>	<b>15</b>	<b>2000</b>	<b>-2000</b>	<b>0</b>		
<b>H. DIFFERED INCOME row (17 +18), from which:</b>	<b>16</b>	1000	-1000	0		
Acc.131	17	0	0	0		
acc.472	18	1000	-1000	0		
<b>I EQUITY AND RESERVES</b>						
<b>I) EQUITY(ROWD20 to 22),from which</b>	<b>19</b>	<b>13.500</b>	<b>0</b>	<b>13.500</b>		
Equity subscribed and undelivered	20	0	0	0		
Equity subscribed and delivered	21	13.500	0	13.500		<b>13.500</b>
Administration patrimony	22	0	0	0		
<b>II) EQUITY BONUSES(ct:104)</b>	<b>23</b>	0	0	0		
<b>III)REEVALUATION RESERVES Balance Credit</b>	<b>24</b>	0	0	0		
(acc.105)						
Balance Debit	25	0	0	0		
<b>IV)RESERVES (ct 106)</b>	<b>26</b>		0			
<b>III) DEFFERED RESULT Balance Credit</b>	<b>27</b>	0	0	0		
(acc.117)						
Balance Debit	28		0			
<b>IV) PERIOD RESULT Balance Credit</b>	<b>29</b>	<b>0</b>	0	<b>0</b>		<b>0</b>
(acc.121)						
Balance Debit	30	<b>2.000</b>	<b>0</b>	<b>2.000</b>		<b>2.000</b>
Liquidation Result			<b>12.584</b>	<b>12.584</b>		<b>12.584</b>
Profit distribution (acc. 129)	31	<b>0</b>	<b>0</b>	<b>0</b>		<b>0</b>
<b>TOTAL EQUITY</b>		<b>11.500</b>	<b>12.584</b>	<b>24.084</b>		
Public equity (ct.1016)	33	<b>0</b>	<b>0</b>	<b>0</b>		
<b>TOTAL EQUITY (rws.32+33)</b>	<b>34</b>	<b>11500</b>	<b>12584</b>	<b>24.084</b>		<b>24.084</b>
<b>GRAND TOTAL - Equity and liabilities</b>		<b>106500</b>	<b>12300</b>	<b>118800</b>		

Note: The Company is not registered as a VAT payer.

In order to estimate the net result of the liquidation we prepared the Profit and Loss statement:

121 Profit and Loss		
The amount of the assets not capitalized	68.000	95.800
Stocks value	12.000	3.000
	2.500	
	1.000	
Activation of differed costs for founding, development	700	
	2.016	
	86.216	98.800
		12.584

Revenues from assets and stocks selling  
 Revenues from provisions  
 Liquidation costs  
 Profit taxes

The amount to be distributed between the associates is reflected through the bank account position.

5121 Bank accounts		
Bank account balance	12.000	92.000
	92.800	92.000
From assets and inventory selling	14.000	2.016
		700
		0
Financial investments and receivables	118.800	94.716
	24.084	

Liabilities to be paid  
 Additional taxes for liquidation  
 Liquidator's fee and other costs  
 VAT to be paid

As we already presented above, the formula for calculating the net liquidation asset is,  $NLA = TA - BD - OD - LC$ , replacing the values presented in the accounting balance sheet and the liquidation balance sheet the result is:

$$NLA = 118.800 - 92.000 - 2016 - 700 = 24.084 \text{ u.m.}$$

The Company issued one thousand shares and based on the NLA the value of each share will be:

$$V_{\text{share}} = \frac{NLA}{NA} = \frac{24.084}{1000} = 2.408 \text{ lei/share}$$

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## **THE INVOLVEMENT OF BANKS IN THE DEVELOPMENT OF ACCIDENTS INSURANCE**

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*According to “Direcției Generale de Reglementări din cadrul Comisiei de Supraveghere a Asigurărilor “ banks sold a quarter of the insurances made in 2005. Bankassurance will develop greatly in the years to come due to the increase of sales of life insurances and the development of groups who offer integrated financial services. In the European Union this activity is unevenly developed. In countries as France, Spain and Italy 60-70% of insurance sales are made through banks. At the opposite side is Great Britain where only 15% of insurance is sold through banks. In Romania in the following 5 years the trend bank assurance will be the same as in Italy and Spain.*

### **1.The insurance market leaders are determined by banks**

The financial institutions involved in banking have a substantial amount of resources which permit the entering on the insurance market under various forms. Still

there are some obstacles concerning this entrance on the insurance market such as insufficient capital and restrictions due to regulations. In long term all these obstacles can be overcome, especially by large institutions.

The deposit institutions can use a variety of methods of entrance on the market function of their size, position and strategically objectives. The institution can use its own capacities or can create or buy industry specific facilities. This can be done by using the current subscription and insurance coverage solution experience specific to insurance companies.

Another method is the creation of mixed societies known as « bank-insurance » through which small and medium size deposit institutions can diversify their activities encouraging the expansion on the market. Large deposit institutions can purchase some insurance companies; in this case the demands concerning capital represent the greatest predicament, provided that regulation restrictions are eliminated.

Modern economy is based greatly on credit as a source of funds for supporting economic growth. The need for credit is big and the banks have a significant role in satisfying the client demands. Credit plays an important role in the economic relations between individuals and corporations. Credit offers the consumers both as physical or juridical entities the possibility to invest in real and financial assets as well as finance their current immediate consumption on the base of future cash flow. The utilisation of credit followed in general the flow of general economic activity. Long term credit is usually used to purchase land and equipment and the short term credit is usually used to finance commercial activities and the purchase of general consumer products for the population. But for all these credits the banks take some guarantees which in turn must be insured ( either insurance for the purchased goods, life and accidents insurance of the person who takes out the credit or insurance for the risk of failure to repay the credit ).

The credit for consumer goods has quickly spread in Romania over the past years and more and more stores have begun selling goods by instalment credit. This now affects the insurance market as well.

The development of consumption credit is presented in Table 1.

Year	Value –billions USD	% of PIB
2000	0,15	0,5
2001	0,22	0,6
2002	0,50	1,1
2003	1,71	3
2004*	2	3,3

Source: Business Magazin, 2 nov 2004, page 36.

Considering a credit for a TV set, the bank takes some safety measures by closing a policy for financial risk of not paying the credit, without the knowledge of the person who buys the credit. So when the instalment credit is not paid regularly, the bank invokes the assurance company to retrieve the prejudice. The assurance companies have to be as discreet as possible when closing the confidential contracts. So the banks close conventions with assurance companies, on a national level, assuring the financial risk of not paying the credit.

This way the risk is being transferred from the banking system into the insurance one. The Board for Insurance Supervising has settled more strict rules for credit insurances and warranties through the Order 3106 from April 27 2004 which refers to applying the rules regarding the restriction of subscribing the consumption and mortgage credits. Through this the net holding back for consumption credit will not be more than 5.000 euro per debtor and the one for mortgage credit not more than 50.000 euro per debtor. The net holding back of the insurance company for the risks of these credits cannot be more than the net value of the assets in the past year multiplied by 12.

We are not always dealing with a risk transfer because not all the unpaid credits will be covered by the insurance company and there are some lacks in the process of

taking proceedings against the debtor retrieving the credit, and the insurance companies often refuse compensations invoking error of procedure.

The outburst of credit for physical persons, and of the leasing, as well as the rising in the price of RCA policies are an impulse in growing incomes on the insurance market. In most of the cases the creditation is conditioned by life insurance and supplementary insurance for accidents and house insurance in the case of mortgage credit. The fact that the banks have put out on the real estate market more money has accelerated the mortgage credit and people now prefer buying a house and paying it in instalments credits than paying a rent.

So at 31.12.2002 real estate credit represented 2,93% in the total given credits in the banking system and by 31,13.2003 the percentage grew to 5.83% in the total credits given in the banking system. In case of a small company administrated by a person, in case of credit facilities for investment, the bank will analyse the seriousness of the client. Even if the credibility is very good and the rating established according to BNR standards is accepted in accordance with bank crediting regulations: mortgage guarantees , minimum permanent merchandise stock pledge , equipment pledge, transfer of debts ( according to case ), the bank can demand to the credit holder a life insurance with a additional accidents insurance, transferred in favour of the bank. The increase of the credit for both physical and juridical persons can therefore have a favorable influence on the accidents insurance market.

The spectacular movements that took place on the general insurance market in 2005 were : ASIBAN climbed from the 8'th to the 4 'th spot. ING remains on top of the life insurance market followed by AIG Life and ASIBAN who took ASIROM's place. The ones who gained the most places are the insurance companies who are in good relations with the banks or even owned by banks such as: ASIBAN (controlled by BRD-GSG, BCR, CEC and Banca Transilvania), BT Asigurări (Banca Transilvania) and BCR Asigurări, a company who registered the highest increase from the top 10

companies of 375% in 2005 relative to 2004 thus climbing 5 places in the top reaching the 5<sup>th</sup> position.

**Top 10 according to gross premium included in general insurance in the year 2005 (mil. Euro)**

2005	2004	Ins. Com.	premium 2004	premium 2005	Evol %	Trend no. places	Share market'04	Share market'05
1	1	Allianz Tiriac	169,1	219	29,5	Stagnation	25,4	22,5
2	2	Asirom	105,3	136,2	29,3	Stagnation	15,8	14
3	3	Omniasig	73,8	116	57,2	Stagnation	11,1	11,9
4	8	Asiban	35,7	72,3	102,5	Going up 4	5,4	7,3
5	6	Unita	40,8	68,1	67	Going up 1	6,1	7,0
6	5	Ardaf	43,1	62,9	45,9	Going down 1	6,5	6,5
7	8	BCR Asig.	30,9	60,7	96,5	Going up 1	4,6	6,2
8	4	Astra	47,6	51,4	8,1	Going down 4	7,2	5,3
9	9	Generali	21,1	30,2	42,9	Stagnation	3,2	3,1
10	15	BT Asig.	8,3	26,9	222,5	Going up 5	1,3	2,8
TOTAL TOP 10			575,7	843,7	46,5		86,5	86,5
TOTAL MARKET			665,5	975,2	46,5		100	100

The insurance market tripled itself in the last 5 years, reaching about 1,2 billions euro in 2005, growing with approximately 40% in comparison with the last year. The insurance products that quickened the market were the credit risks insurance, bought by the banks to cover the risks of unpaid credits, and the life and accidents insurance, houses and Casco, deals closed by the bank's clients, according to the credit's destination: nominated personal needs, mortgage, real estates, auto. A quarter of the sales of insurance policies closed in 2005 was realised through banks, which sold insurances of about 300 millions euro.

Bank assurance is defined in the insurance law to be the distribution activity of insurance products complementary to the products offered by the credit institutions, developed through the credit institutions' network or the sale of insurance products and the products offered by the credit institutions through the common distribution channels.



According to the law, insurance companies can distribute through banks only insurance products complementary to credits, for example life insurance, unpaid, house, auto.

Insurance products sold by banks are more simple than those that can be bought directly from the insurance companies. Also, the commission paid by the insurance company to the banks for the distribution of the insurance products is smaller than the one paid to the agents or to the brokers.

## **2. The information flow of the insurance associated to credit**

Another aspect of the banks implication in the insurance activities is bank assurance – insurance associated to credits. Such a product is OPTIMIST – group life insurance contract signed by *BRD- G.S.G. with AVIVA Life Insurance*. This partnership means giving preferential insurance terms to BRD clients who take out credits that demand making insurance.

This product targets clients, as physical person, which requests from BRD – GSK: real estate credit and credit for personal needs guaranteed with mortgage.

What's new with this product:

- it is a group insurance that implies granting preferential terms to BRD clients;
- the insurance premium is paid monthly together with the credit rate and is taken automatically from the current account;
- the insurance premium is calculated each month as a percentage applied to the credit balance.

Events insured: death, temporary invalidity, total and permanent invalidity.

Indemnity is paid in the case of:

- death/ total and permanent invalidity: credit balance + interest calculated for maximum 7 months;
- temporary invalidity: payment relief for the insurance premium on a 6 month period.

Advantages for clients advantageous cost for clients considering that the premiums were negotiated by the banks and these decrease each month together with the credit balance consistency in time of the insurance premium independent of the increase in age of the insurance holder and his health state accessibility concerning payment of monthly insurance premium being easier to handle by the client taking the premiums automatically from the account at the same account deadline relief's the client from relocating in order to pay the monthly premium a competitive alternative to existing insurance offers.

### **3. Accidents insurance and long term savings**

An other problem concerning banks' involvement is the one about attracting clients that are willing to put their savings into a bank, in insurance company's detriment. The public system of old-age pension is poor, because 18% of Rumanian people have, according to the statistics presented by the World Health Organisation, over 60 years old. In a couple of decades, because of the demographic falling down, elderly people will have even a larger share in the people structure. The question is how will the public system of old-age pensions survive in 20-30 years from now.

The answer is hard to anticipate, but one thing is sure at this time: the early personal saving for a worry less old age. Insurance companies are making market researches, trying to establish the current and future needs of insurance and personal protection, carefully preparing the introduction of the private old-age pension on the market. Almost all insurance companies have a product suited to these demands, called old-age pension, saving plan or old-age pension plan.

The most interested clients are the employees earning more than five gross medium wages or the ones whose employer pay the tax to the public retirement fund equalling the minimum sum, afferent to the minimum wage on the economy, because of the high contributions, preferring to pay the employees "on the black market".

The first ones, because even if they want, they can't receive a pension higher than five times the medium pension from the public system which will be assigned in the year when they will reach the legal retirement age. But even more interested are the employees who earn just a small part of the incomes legally, on the work book, the rest being obtained at the understanding with the employer.

Both kinds, but the small businessman also who don't want to join the public pension system, can choose from 10-15 private pension offers provided by the insurance companies. That is why we will approach the impact of the pension plan with additional clause of death by accident, death by car accident, permanent or partial invalidity from accidents and from the exoneration from payment of the premium insurances in case of invalidity.

The pension is available on the market in two different types: as a traditional product, where the insurance company guarantees a minimum sum, and as a unit-linked product, when the risk which comes with the investment is laid on the insurance holder, choosing the percentage of the insurance policy belonging to the insurance and the percentage belonging to the investment program, also the income of this investment program: more or less risky.

In this field the insurance company is in competition with other financial institutions of the same profile which are willing to keep money on long term, giving capitalization according to the efficiency of each financial institution. The insurance companies enter the competition with other financial institutions willing to keep money and invest it on long term. The way and the efficiency used to fructify these funds by an insurance company in the bank's detriment is crucial in fundament a potential client's decision to place his savings.

For a guaranteed pension of 1.500 RON (which preserve their purchasing power through indexing ) offered by the insurance companies that sell traditional products, the monthly premium to get started now at 30 years of contribution, is about 250-300 RON.

In other words, if we don't have any inflation at all until then, the 250 RON will become through capitalization in 30 years time a 1.500 RON rent.

If we take the case of insurances is foreign currency, for example USD, where the inflation is less than 2%, is easier to calculate. So, to a 1.250 USD saving into a bank for 30 years with a medium interest of 5% a year, the capitalized value will reach 88.450 USD. In these terms we won't have any covering in case of death by accident or other occasions during this period.

An insurance company – Aviva, to the same annual contribution as the bank account case, which estimates a rate of investment earnings of 7,5%, offers a value to the insurance policy of 95.770 USD in 32 years time, sum that can be make into a monthly rent of 790 USD. We can observe that the insurance company gives covering in case of death of 10.000 USD during this period and a higher profit rate than the one offered by the bank. At the same contribution, a bank would offer at a medium interest of 7,5% a year, in this period of time more than 160.000 USD.

It is not just Aviva's case, Alliantz Tiriac, in the pessimistic case when the investment has an efficiency of 5,6% a year for 30 years, to a contribution of 250 USD a year, at the end of the period there will be 13.202 USD in the account. During this period the client has covering in case of death of 10.000 USD. Banked for 30 years with the same interest, the 250 USD a year will become 19.708 USD. In the optimistic case, at a interest of 16,3% a year, the insurance company estimates that the value of the account will reach 107.495 USD(the covering stays at 10.000 USD). We can observe that insurance companies give a better efficiency than the banks (Aviva has in the pessimistic case regarding the evolution of the investment of 7,5% a year to USD), the costs of the contract and the closing of the deal make the insurance policy's price a little higher.

The additional clauses attached to the pension products which also cover accident risks don't make the price higher with a significant percentage. The Interamerican clauses for different coverings (invalidity, death by accidents, chirurgical interventions)

make the premium higher with a few extra lei, according to the size of the covering in case of death, invalidity or payment for hospitalisation and surgery.

Regardless of where the savings are made in a bank the mutual fund ,retirement fund, or insurance fund this must be done as early as possible. Due to the capitalisation of interests the first 5 years of contribution are worth more then the last 5. An issue which arises for the future is where to invest the money on a long term basis. A company with medium and long term financial engagements needs means of placement that rise to their demand in order to cover them without any difficulties.

Even more than that a insurance company who seeks to conserve and increase in time the value of the money collected from its clients in the form of insurance premiums must offer increased protection towards the inflation effects of the market and the devaluation of national currency. Even though it is backed up by more then 10 years of experience the Romanian financial market is not capable of offering such placement means regardless if referring to the segment of the market related to state titles or the market of capital. The need of placement instruments becomes increasingly pressing as the revenues from the insurance premiums rise. During the working period of the one paying the contributions, the pension contributions should be invested into a mix of assets with growth potential, to preserve on long term the real value of the funds.

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# THE STATE FINANCIAL CONTROL

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***Abstract:** The essential feature of market economy is the balance between independent economic agents and the autonomous ones as this type of economy functions without any restrictions imposed by the state, thus each economic agent is free to spend, use, produce and save as much as they consider fit in order to follow their own economic interests in the general context of matching them with the real needs and interests of society.*

*Under such circumstances, the new commercial societies (firms) have become autonomous subjects for economy. Consequently, the relationships between the state and the commercial societies achieved a fiscal nature, in most of the cases, where the state exercises its fiscal supremacy. Thus, the societies feel compelled to give up part of their net internal product they produce or earn on the market in the form of duty and taxes.*

***Key words:** fraud, offence, delinquency, tax regime, customs regime, operational control, unforeseen control.*

## **1. The targets of the state audit**

The state audit includes in its domain the administration and usage of the public financial means, as well as the compliance with the financial accounting rules in the activity carried out by the economic units (self-governing state companies, trading companies, etc), concerning the way they fulfill their obligations towards the state.

To be more specific, the targets of the state audit are the following:

- The administration and usage of the assets received from the state for expenses related to the functioning and maintenance of the central and local bodies of state administration and of the state financed units;
- The use of the assets received from the state to make investments of general concern, the funding of activities and products for other destinations too, according to the legal provisions;
- The use of the own means and funds and the compliance with the financial accounting rules in the activity of the self-governing state companies and of the national trading companies;
- The exactness and the truthfulness of the data recorded in the accounting and the constitutive acts of the trading companies and the other economic units, with the purpose of establishing correctly and fulfilling entirely and in due time all the fiscal and financial obligations towards the state, etc.

The field of state audit also includes issues concerning the prevention and fight against frauds, offences, and delinquencies of the tax regime and the customs regime. This type of audit is operational and unforeseen and has as main targets to apply and execute the fiscal laws and customs regulations, trying to prevent any kind of elusion or evasion from the paying of duties and taxes. It also includes the compliance with the trading rules, in an attempt to prevent the contraband trade and all the means forbidden by the law; other activities established by the law.

## **2. Organizing the state audit**

The central body of the executive power, which applies the strategy and the program of the Government in the field of economic policy and public finance policy, is the Ministry of Public Finance.

The Ministry of Public Finance performs the following tasks:

- The general administration of the public finance;
- It acts to encourage the economic activity on criteria of efficiency and economic balance, by using economic, financial, and monetary

instruments, according to the requirements of the market economy, by activating the freedom of initiative at a macro level;

- It acts to create the frame for fair competition in the economy and it supervises the compliance with the legal provisions concerning competition;
- Through its bodies, it performs the audit and the financial supervision of the state bodies and institutions, it controls the financial activity of the self-governing state companies and of the trading companies, as well as of the other social and economic units;
- Through its specialized agents, it performs, on behalf of the state, the control over the administration and usage of the financial means of the central and local bodies of state administration, as well as over the state institutions, of the financial accounting compliance in the activity of the self-governing state companies, the trading companies and other economic units, related to the fulfillment of the obligations towards the state.

The state audit is organized and it functions within the Ministry of Public Finance through two organs, which are:

1. The general authority of state audit;
2. The Fiscal guard.

For counties and for the capital, there are authorities of state audit and departments of the fiscal guard that work within the structure of General regional authorities of public finance.

### **2.1.The general authority of state audit**

The general authority of state audit of the Ministry of Public Finance and its subordinate units have the following attributions:



- They control the administration and usage of the assets received from the state for expenses related to the functioning and maintenance of the central and local bodies of state administration and of the state financed units;
- They control the use of the assets received from the state to make investments of general concern, the funding of activities and products for other destinations too, according to the legal provisions;
- They control the use of the own means and funds and the compliance with the financial accounting rules in the activity of the self-governing state companies and of the national trading companies;
- They control the exactness and the truthfulness of the data recorded in the accounting and the constitutive acts of the trading companies and the other economic units, with the purpose of establishing correctly and fulfilling entirely and in due time all the fiscal and financial obligations towards the state, etc.
- They fulfil also other set control attributions, according to the law, which are the responsibility of the Ministry of Public Finance.

The Ministry of Public Finance, based on the observations resulting from the control performed by its specialized bodies, has the right to prescribe the following:

- Adopting the measures that will remove and prevent the irregularities observed in the financial accounting activity of the central and local administration, as well as of the self-governing state companies;
- Correcting and drawing up the balance sheets and paying to the budget the taxes and other legal incomes due to the state;
- Applying the measures to comply with the legal provisions in the field of prices and rates (later on, by instituting the Competition Department, the attributions in this field have been restrained);
- Suspending the application of measures that don't comply with the fiscal and financial accounting rules.

Within a calendar year, an economic unit may be object to only one accounting control, for the truthfulness of balance sheets and for determining the sums due to the state for whatever reason; the period that makes the object of the control is the entire period since the previous control of the same kind and targets, which, according to the law, has not been written-off.

An exception to this are the actions of documentation, analysis and supervision of the implementations of rules, which can be performed only after notifying the economic unit and receiving its advice, as well as the verification of the complaints about possible evasion of the fiscal and financial laws, which are performed as often as needed.

The maximum duration for a control action for one economic unit is of three months, regardless of the period that is object of the control.

During the accounting control meant to determine the amounts of money due to the state for whatever reason, the economic units have the right to be assisted by a consultant, who is usually chosen from the list of certified accountants or chartered accountants.

The measures prescribed after the control are communicated to the ones who had been the object of the control within 30 days from the end of the verification and may be disputed, at the Ministry of Public Finance, within 30 days from the date they were received.

The general authority of state audit and the local authorities of state audit of counties and of Bucharest are structured by functional services, as in the following model:

1. The methodology, coordination and programming service for the activity of state audit from the central office and the local authorities supervises the completion of its own tasks and the connection to the other authorities of the Ministry of Public Finance, other ministries and central institutions;
2. The control service, created for the following operations:
  - o Respecting the financial discipline and the payments to the economic units;

- Restructuring the activity of the national trading companies and administrating the public patrimony;
- Fulfilling the financial obligations towards the public funds and using the amounts of money received from the state to finance the economic activities and the public institutions;
- Respecting the monetary discipline and the legal provisions concerning the trading transactions with foreign economic units;
- Of the debts and internal and external commitments of the state, administrating the state guaranties;
- Of the financial activities of the self-governing state companies, the organization and functioning of their own audit;
- Complying with the financial accounting rules in the activity of the institutions and the self-governing state companies in the field of national defense and public order;
- Complying with the financial accounting rules in the activity of the insurance and re-insurance companies.

The local authorities of financial audit from the counties are structured by functional services, according to the number of specialized positions.

## **2.2 The fiscal guard**

The fiscal guard is under the command of a general commissioner and it has a central apparatus that has the right to act on the entire Romanian territory, and a territorial apparatus, organized by county departments and of the capital. The activity of the Fiscal Guard is coordinated by the guard command.

The departments of the Fiscal Guard have control competence on the territory of the county (or of the capital) where they are organized. The extension of the control can only be achieved with the approval of the general commissioner or of a deputy.

Each department of the Fiscal Guard is managed by a department chief-commissioner, who is subordinate to the general commissioner.

The financial accounting and administrative operations specific to the departments of the Fiscal Guard are achieved through the general authorities of public finance.

The central apparatus and that of the departments of the Fiscal Guard are structured in specialized divisions, managed by a division chief-commissioner, and in other sections, according to the organizational chart approved by the minister for Finance.

In the management activity, the general commissioner and the department chief commissioners are supported by a number of deputy general commissioners and deputy department chief commissioners, as is established by an order of the minister for Finance.

The Fiscal Guard command carries out its activity based on the activity program, and it meets every three months or more often if that is the case, to analyze mainly the following:

- The periodical reports of managing board of the Fiscal Guard, to establish the measures needed to improve its activity;
- The collaboration between the Fiscal Guard and the authorities of the Ministry of Public Finance;
- Globally and by stages, the results obtained by the Fiscal Guard in the actions organized in collaboration with various government bodies;
- The proposals for measures concerning the improvement of the legal frame, with the purpose of canceling the overlaps, blanks, and dysfunctions of any kind;
- The completion and updating of the activity programs, based on the current needs.

The Fiscal Guard Command also informs the leaders of the Ministry of Public Finance, on a regular basis, about the special problems occurring in its activity, proposing the measures needed.

The control papers are made out according to the legal provisions, the working rules for the employees of the Fiscal Guard and the methodologies established by the Ministry of Finance. The record of finding and sanctioning the offences is made out to sanction both fiscal infringements and other kinds of actions, according to the provisions of special laws, which also dispose the complementary measure of seizure.

The control papers may be disputed through the specific administrative means, according to the provisions of the Law no. 506/4.10.2001.

The objections, disputes or complaints against the control papers made out by the commissioners of the Fiscal Guard will be dealt with according to the provisions of the laws and regulations concerning their adjustment.

The documents establishing duties, taxes, and other sums that must be paid to the state budget, resulting from the performed controls, are transmitted to the fiscal body to be supervised and cashed, according to the specific methodology made out by the Ministry of Finance.

### **3. The Accounting Court**

The Accounting Court is the supreme institution of audit, which also fulfils jurisdictional attributions over the means of formation, administration and usage of the financial resources coming from the state and from the public sector. It functions in collaboration with the Parliament and it carries out its activity independently, according to the laws.

The 139 article of the Romanian Constitution organizes the Accounting Court by the following functions:

- The Accounting Court performs the control over the means of formation, administration and usage of the financial resources coming from the state and from the public sector. According to the law, the Court also fulfils jurisdictional attributions;

- The Accounting Court annually submits to the Parliament a report about the management account of the national public budget from the expired budget year, including the irregularities observed;
- The members of the Accounting Court, chosen by the Parliament, are independent and irremovable, according to the law. They are object to the incompatibility meant for judges.

The organization and functioning of the Accounting Court are settled by the Law no. 77/2002. According to the law, the Accounting Court has the following attributions:

- It controls the formation, administration and usage of the financial resources coming from the state and from the public sector, as well as the means of management of the public and private state patrimony and of the patrimony of territorial administrative units, supervising the compliance with the laws and the way that the principles of economical use, effectiveness, and efficiency are applied in the management of the material and financial means;
- It performs the judgment and takes the decisions concerning the payment of civil compensatory damages for the damage done by the administrators, managers and accountants, as well as by the other kinds of persons under the jurisdiction of the Accounting Court, according to the law.

To perform its function of control over the formation, administration and usage of the financial resources coming from the state and from the public sector, as well as the means of management of the public and private state patrimony and of the patrimony of territorial administrative units, The Accounting Court controls:

- The formation and usage of the state budget resources, of the resources from the budget of the state social insurance and the budget of the

- territorial administrative units, as well as the circulation of assets between these budgets;
- The formation, usage and management of the special funds and of the treasury funds;
  - The formation and management of the public debt and the statement of the government guaranties for internal and external credits;
  - The use of the budgetary allowances for investments, of grants and transfers and other kinds of financial support from the state or from the territorial administrative units;
  - The formation, administration and usage of public funds by the autonomous public authorities and by the public institutions legally acknowledged, as well as by the autonomous state bodies of social insurance;
  - The statement, evolution and means of administration of the public and private state patrimony and of the patrimony of territorial administrative units by the public institutions, self-governing state companies, and national companies, as well as the franchising or renting of goods that belong to the public property;
  - The formation, usage and management of the financial resources concerning the protection of the environment, the improvement of the quality of living and working conditions.

The main targets that will be taken into consideration during the control activities over the economic units are the following:

- The level of the external prices obtained, the terms of payment used and the degree to which the complete cashing of the foreign currency has been insured in due time for the export transactions, and especially for the products of which there is a shortage on the internal market or the products that have a tradition for export;

- The efficiency and legality of the use of monetary funds obtained through external credits, especially of the ones obtained with government guaranties;
- The degree to which the license regime and the customs duty regime ensure the protection for export of the natural resources and of the internal industrial production for imports;
- The causes that produced important losses for certain self-governing state companies and national trading companies;
- The degree to which the economic units ensure the compliance with the legal procedures concerning the use of the funds destined to research by the institutions of specific profile;
- Respecting the destinations specified by the law for the grants given from the state budget to the self-governing state companies and to the economic units;
- Respecting the legal provisions concerning the following:
  - The stock-taking and re-assessment of the fixed assets;
  - The re-assessment of the current assets;
  - The renting and the sharing of administrative location of subunits of trading companies;
  - The selling of assets;
  - The selling of shares, etc.
- The legality and the efficiency of providing certain legal persons with money advances.

The main targets that will be taken into consideration during the control activities over the budgetary units are the following:

- The means of formation, appropriation, and usage of the funds resulting from the selling of the shares of the tenements;
- The management of the patrimony of the territorial administrative units and public institutions, the compliance with the legal provisions



- concerning the renting of spaces and goods, as well as the legal provisions concerning the franchising of lands;
- Complying with the legal regulations concerning the cashing and using of the school fees in foreign currency collected from foreign citizens;
  - The misappropriation of funds, from one budget year to another, and from the approved destinations;
  - Complying with the legal regulations concerning the capital expenditure related to the following:
    - Approving, making out the technical and economic documentation;
    - Ensuring the funding sources;
    - Organizing the auctions;
    - Making advance payments;
    - Performing the reception and the payment;
  - Complying with the legal provisions concerning the encashment and usage of the extra-budgetary incomes;
  - The legality and the efficiency of providing certain legal persons with money advances.

The control performed by the Accounting Court is subsequent and concerns the compliance with the legal dispositions related to the management and use of the public funds (material and financial means).

The Accounting Court has as main attribution the verification of the following:

- The general annual account of the government budget implementation;
- The annual account of the state social insurance budget implementation;
- The annual accounts of the special funds budget implementation;
- The accounts of the treasury funds;
- The annual account of the public debt, of the state, and of the statement of the government guaranties for the internal and external credits received by other legal persons.

In fulfilling the attribution described previously, the Accounting Court, based on its own control program, verifies, during the budget year and at its end, the following:

- The accounts of the public management of money, other public values and material goods;
- The accounts of the cash execution of the public budgets;
- The implementation accounts for the budgetary grants and allowances for investments given to other beneficiaries than public institutions;
- The balance sheets and implementation accounts for applicants of budgetary credits, for the administrators who manage the funds that fall under the public budget regime;
- The accounts of the transactions concerning the public debt.

By verifying the accounts, the Court establishes if:

- The accounts that are subject to its control are exact and according to the reality and if the stock-taking has been performed within the terms and under the conditions specified by the law;
- The incomes of the state, of the territorial administrative units, of the state social insurance, and of the public institutions completely or partially financed through extra-budgetary means have been legally established and cashed within the terms specified by the law;
- The expenses have been committed, settled, ruled out, paid and recorded according to the legal regulations and in compliance with the provisions of the budget law;
- The grants and allowances for investments have been given from the budget or from the special funds, under the legal conditions, and if they have been used according to the established destinations;
- The contracting of public loans, the rebate of their matured installments, and the payment of the due interest rates has been performed under the legal conditions;

- The debentures and obligations of the state and of the territorial administrative units are justified or secured, and if the assets are protected according to the law;
- The franchising or the renting of public goods has been performed under the legal conditions;
- The financial management meets the quality standards concerning economical use and the efficiency parameters.

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# CREDIT RISK MANAGEMENT

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## ABSTRACT

*Credit risk management lies at the heart of survival for the vast majority of banks. The profile of customers (WHO has been lent to) must be transparent and the risks associated with the key banking products (WHAT has been lent) must be understood and managed. The maturity profile of loan products (for HOW LONG the loans have been made) interacts strongly with liquidity risk management, thus credit risk can be limited by reducing connected- party lending and large exposures to related parties.*

### **I. Classification of the banking risks**

The banking domain is very large and in a continuous change being characterized by the existence of many types of risks:

#### **A. Significant risks**

The classification of significant banking risks, taking into consideration their importance in ensuring a prudential activity, has the following structure:

1. The credit risk
  - the country risk
  - the transfer risk
2. The market risk
  - the price risk
  - the foreign currency risk
  - the exchange rate risk

3. The liquidity risk
4. The operational risk- the juridical risk
5. The reputation risk

### **B. Other types of risk**

Besides the significant risks there are a series of risks that act independent or interdependent of the significant risks namely:

1. The capital risk
2. The solvency risk
3. The personnel risk (attacks, kidnappings, death, injuries, sexual harassment, insufficient knowledge of the employees)
4. The risk of theft and fraud (internal, external)
5. The risk of damage of the tangible assets
6. The risk of activity interruption/ system mal functioning
7. The risk of physical loss or damage (fire, arson, explosion, flood, earthquake)
8. The risk of inadequate sales practices (the lack of the client's signature, breach of confidentiality, insufficient knowledge regarding the market risks)
9. The risk of banking crisis
10. Other risks

## II. General aspects regarding the significant risks:

The credit risk: Credit or counterparty risk - defined as the chance that a debtor or financial instrument issuer will not be able to pay interest or repay the principal according to the terms specified in a credit agreement – is an inherent part of banking. Credit risk means that payments may be delayed or ultimately not paid at all, which can in turn cause cash flow problems and affect a bank's liquidity. Despite innovation in the financial services sector, credit risk is still the major single cause of bank failures. The reason is that more than 80% of a bank's balance sheet generally relates to this aspect of risk management.

Banks engaged in international lending face additional risks, the most important of which are country and transfer risks. The country risks encompass the entire spectrum of risks posed by the macroeconomic, political, and social environment of a country that may affect the performance of borrowers. Transfer risks are the difficulties that a borrower might have in obtaining the foreign exchange needed to service a bank's loan.

Additionally, foreign currency risk aspects may also affect loan classification in cases where a debtor has borrowed in one currency but generates cash flow in another currency. In effect, the foreign currency risk aspect magnifies the credit risk taken by a bank, cases relevant in emerging market economies or in economies where the domestic currency is unstable and/or lacks full convertibility.

The market risk: is the risk that a bank may experience loss or non-realization of the estimated profits due to unfavourable movements in market prices, interest rates and currency exchange rates. Market risk results from changes in the prices of equity instruments, commodities, money and currencies. Its major components are therefore equity position risk, commodities risk, interest rate risk and currency risk. Each component of risk includes a general market risk aspect and a specific risk aspect that originates in the specific portfolio structure of a bank. In addition to

standard instruments, market risk also applies to various derivatives instruments, such as options, equity derivatives or currency and interest rate derivatives.

The liquidity risk: Liquidity represents a bank's ability to efficiently accommodate the redemption of deposits and other liabilities and to cover funding increases in the loan and investment portfolio.

A bank has adequate liquidity potential when it can obtain needed funds (by increasing liabilities, securitizing, or selling assets) promptly and at a reasonable cost. The importance of liquidity transcends the individual institution, because a liquidity shortfall at a single institution can have system wide repercussions.

The operational risk: is the risk that a bank may experience loss or non-realization of the estimated profits due to internal factors (inadequate development of the internal activities, malfunctioning of the information systems, reporting systems, inadequate internal risk monitoring rules) or external factors (economic conditions, changes in the banking environment, technological progress). In the absence of efficient tracking and reporting of risks, some important risks can remain ignored, do not trigger any corrective action and can result in disastrous consequences.

The reputation risk: is the risk that a bank may experience loss or non-realization of the estimated profits due to the clients' lack of trust in the integrity of the credit institution. The measures for the mitigation of this type of risk may comprise the thorough analysis of the media communicates and information and clarifying the mal-intentioned or negative ones that affect the image, performances and reputation of the bank. Also the bank should try to find solutions to the clients' complaints and give professional advice at the level of standards practiced by its competitors.

### III. The Aggregate Loan Portfolio Analysis

- A summary of the major loan types, including details of the number of customers, average maturity, and the average interest rate earned;
- Distribution of the loan portfolio, including various perspectives on the number of loans and total amounts, for example according to currency, short-long term maturities, industrial and/ or other pertinent economic sectors, state-owned and private borrowers, and corporate and retail lending;
- Loans with government or other guarantees;
- Loans by risk classification;
- Nonperforming loans.

#### Nonperforming loans

Loans are often considered to be nonperforming when principal or interest on them is due and left unpaid for 90 days or more.

The nonperforming loan portfolio is an indication of the quality of the total portfolio and ultimately that of a bank's lending decisions.

The aggregate level of provisions indicates the capacity of a bank to effectively accommodate credit risk.

The analysis of a nonperforming loan portfolio

- Aging of past-due loans, including principal and interest, by more than 30, 90, 180, 360 days. These classifications can be broken down by type of customer and branch of economic activity to determine overall trends and whether or not all customers are affected equally.
- Reasons for the deterioration of the loan portfolio quality, which can help identify possible measures that can be undertaken by the bank to reverse a given trend.
- A list of nonperforming loans, including all relevant details, should be assessed on a case-by-case basis to determine if the situation is reversible, exactly what can be done to improve repayment capacity, and whether or not collection plans have been used.



- Provision levels should be considered to determine the bank's capacity to withstand loan defaults.
- The impact on profit and loss accounts should be considered to determine exactly how the bank would be affected by the deterioration of asset quality.

#### **IV. Credit risk management portfolio**

Credit risk is the most common cause of bank failures.

There are minimum standards for credit risk management.

Specific credit risk management measures typically include:

1. Policies aimed to *limit or reduce credit risk*, such as policies on concentration and large exposures, adequate diversification, lending to connected parties, or over-exposures.
2. Policies of *asset classification*. These mandate periodic evaluation of the collectibles of the portfolio of loans and other credit instruments, including any accrued and unpaid interest, which expose a bank to credit risk.
3. Policies of *loss provisioning* or the making of the portfolio of allowances at a level adequate to absorb anticipated loss – not only on the loan portfolio, but also on all other assets that are subject to losses.

##### Workout procedures

- Reducing the credit risk exposure of a bank, for example by having the borrower provide additional capital, funds, collateral or guarantees;
- Working with the borrower to assess problems and find solutions to increase loan service and repayment capacity, such as the provision of advice, the development of a program to reduce operating costs and/ or increase earnings, the selling of assets, design of a debt restructuring program, or changed loan terms;

- Arranging for a borrower to be bought or taken over by a more creditworthy party, or arranging for some form of joint-venture partnership;
- Liquidating exposure through out-of-court settlement or by taking legal action, calling on guarantees, foreclosing or liquidating collateral.

### Policies to limit or reduce credit risk

#### ***Large exposures.***

Most countries impose a single- customer exposure limit of between 10 and 25 percent of capital.

The Basel Committee on Banking Supervision has recommended a maximum of 25%, with the intention of reducing it to 10% as soon as this is practical.

The adequacy of a bank's policies, practices and procedures in identifying common or related ownership, the existence of effective control, and reliance on common cash flows.

***Related-party lending.*** Lending to connected parties is a particularly dangerous form of credit risk exposure.

Related parties typically include a bank's parent, major shareholders, subsidiaries, affiliate companies, directors, and executive officers.

Over exposure to geographical areas or economic sectors.

#### *Asset classification*

Assets are classified at the time of origination and then reviewed and reclassified as necessary a few times per year.

Economic trends and changes in respective markets and the price of goods also affect evaluation of loan repayment.

- ***Standard, or pass.*** When debt service capacity is considered to be beyond any doubt: loans and other assets that are fully secured by cash or cash substitutes (e.g. bank certificates of deposit and treasury bills and notes)
- ***Specially mentioned, or watch.*** Assets with potential weaknesses that may, if not checked weaken the asset as a whole or potentially jeopardize a borrower's repayment capacity in the future: credit given through an inadequate loan

agreement, a lack of control over conditions that may negatively affect the borrower in the future, it also applies to borrowers with an adverse trend in their operations or an unbalanced position in the balance sheet, but which have not reached a point where repayment is jeopardized.

- ***Substandard.*** This classification indicates well-defined credit weaknesses that jeopardize debt service capacity, in particular when the primary sources of repayment are insufficient and the bank must look to secondary sources for repayment: collateral, the sale of a fixed asset, refinancing, or fresh capital. Substandard assets typically take the form of term credits to borrowers whose cash flow may not be sufficient to meet currently maturing debts or loans, and advances to borrowers that are significantly undercapitalized. They also include short-term loans and advances to borrowers or which the inventory-to-cash cycle is insufficient to repay the debt at maturity. Nonperforming assets that are at least 90 days over due are classified as substandard.
- ***Doubtful.*** Such assets have the same weaknesses as substandard assets, but their collection in full is questionable on the basis of existing facts. The possibility of loss is present, but certain factors that may strengthen the asset defer its classification as a loss until a more exact status may be determined. Nonperforming assets that are at least 180 days past due are classified as doubtful, unless they are sufficiently secured.
- ***Loss.*** Certain assets are considered uncollectible and of such little value that the continued definition as bankable assets is not warranted. This classification does not mean that an asset has absolutely no recovery or salvage value, but rather that it is neither practical nor desirable to defer the process of writing it off, even though partial recovery may be possible in the future. Nonperforming assets that are at least one year past due are also classified as losses, unless such assets are very well secured.

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## **Non-Banking Financial Institutions-Future Credit Institutions**

**Conf. univ. dr. Daniela Zăpodeanu, University from Oradea**

*Financial activity, through its specific, is an activity that must be ruled, the implications of banking risks that may appear being major. Recently, activity of non-banking financial institutions from Romania was ruled. Facing that non-banking financial institutions are developing specific credit activities, was established as supervising authority National Bank of Romania.*

*In this context is rising the problem of instituting supervising and ruling activity of non-banking financial institutions, if these will be concretized in prudential rules for preventing financial risks specific to banks. As a big part from societies entering under the incidence of a new legislative framework do not have an important market quotas, is expected to produce mutations in fusion kind at Non-banking Financial Institutions level.*

*More than that, appears the problem of mark off between the others credit institutions and non-banking financial institutions, practically, to mark off banking system, respective a future enlargement of banking system from Romania.*

Integration of financial markets based mainly on two fundamental premises, capital's mobility and substituting financial assets<sup>1</sup> is encouraged by competition's rise, technology development and legislative framework. On the background of financial market's integration, formation of conglomerates represents a reality of last three decades, no matter what the modality through is realized: acquisition of majority participation, acquisition of the other entity or entity's fusion.

Banks started to offer diverse services to make more profitable their distribution networks and finally to obtain profit's raised. In the same time, non-financial companies entered in financial arena in this period of time. As a result, financial markets became more competitive and now exists more societies offering financial services called non-banking financial institutions.

Especially we are talking about companies for financing automobiles and producers of consumption goods, which wanted to increase selling for their products.

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<sup>1</sup> Corina Weidinger Sosdean - Euro and international financial markets, Mirton Publishing House, Timisoara, 2005, p. 176

Ford Motor Credit acquisitioned Ford Nationwide Financial Corporation and another credit and economies societies in other states, becoming the biggest company holding of economies and credit in United States, offering services of mortgage, deposits and credit cards<sup>2</sup>.

To become financial institutions full service, brokerage societies became financial conglomerates, offering banking product to their clients. Supplementing banking products with the insurance ones determined, also, insurance companies to become financial conglomerates. We assist at interference of bank's universal activities, specialized or business, and mutual banks (credit cooperatives) or economies banks with the activity of non-banking financial institutions.

Non-banking financial institutions, whose main feature is that they cannot constitute deposits, are: societies for financing selling with buying option, mortgage or real estate credit societies, leasing societies, factoring societies, insurance societies, brokerage societies, collective placement societies, etc.

The main problem that appears in connection with formation of conglomerates is the one of risks associated to the activity of each institution that is a part of a conglomerate, respective the one of preventing financial risks through instituting some prudential norms to assure market's discipline. Market's discipline represents the situations of enforcing some constraints for diminish the risks assumed by ruling authorities. Not accidentally we are talking about supervising authorities at plural, because there are not rules to realize prudential supervise approach at financial conglomerates level in its ensemble, this stays at sector's level. So, each sector has specific rules but also distinct control authority, that has in specific cases a relative right for obtaining information from control authorities of the other sector<sup>3</sup>.

If regarding bank markets, insurance market and capital market, things are from this point of view (prudential rules and supervising authorities) placed and we cannot

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<sup>2</sup> Davis S. Kidwell, Richard L. Peterson – Financial Institutions Markets, and Money, The Dryden Press, 1995, p. 399

<sup>3</sup> Cristina Ciumas – International Insurances, Architecture and problematic at the beginning of the III rd millennium, Intelcredo Publishing House, deva, 2001, p 88

think a banking system without supervising authority, regarding financial institutions activating on the non-government credit market, but are not credit institutions (they are not a part of banking system) it doesn't certainly exist specific rules and supervising authorities. Diverse countries enforced for these institutions similar rules with the ones for credit institutions, or specific minimum rules, or they enforced rules only for the big societies.

Similar of world wide trend, Romanian banks developed their products and services specific to leasing societies, insurance societies, capital market intermediary societies or collective placement organisms, through participations at distinct societies (according legislation in act), forming financial groups. E. g. Financial Group of Commercial Bank of Romania comprises along bank also BCR Insurance SA, BCR Leasing SA, BCR Securities SA (through fusion of two societies of securities in which BCR had participation as a result of the fusion BCR and Bancorex), BCR Asset Management SA (society for administration of open funds for investment, risk funds and investment society, authorized by National Commission of Securities), but along other banks formed financial groups: BRD, ING Bank Romania, Raiffeisen Bank Romania, Alpha Bank Romania, etc.

Is normal the development of financial groups in Romania having as a nucleus an universal bank because banking system developed on an existing structure before 1990; in consequence banks offer integral financial services to their clients, being capable in any moment to find solutions to their financial problems.

Financial market's discipline and operator's on these markets is assured in our country by three supervising authorities: National Bank of Romania (B.N.R.), National Commission of Securities (C.N.V.M.) for capital market, Commission for Supervising Insurances (C.S.A.) for insurance market. In this context, is raised the problem of opportunity of instituting supervising and ruling of the non-banking institution's activity, recently adopted in Romania<sup>4</sup>.

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<sup>4</sup> Government Ordinance no 28/2006 – Official Monitor no 89/31.01.2006

Appealing assuring and maintaining of financial stability, financial intermediary in its ensemble, legislative gave the supervising and monitoring of non-banking financial institutions to banking supervising authority: B.N.R., so enforcing rules of functioning similar to the ones for credit institutions. Are endorsed in this way financial leasing activities, mortgage and real estate credit activities, commercial transaction's funding of micro-credit, selling consumption goods with part payment, and activities developed by guarantee funds, reciprocal help houses, and pawn shop.

Concrete modality of realizing market's discipline instituting at B.N.R. level of three books: overall book, special book and evidence book, indicates a simple evidence or a monitoring for majority of institutions and supervising only for the big ones, B.N.R. being in the impossibility of comprising all 4617 institutions under supervising; from these 4308 are reciprocal help houses and pawn shops, that are only highlighted<sup>5</sup>.

Why B.N.R., and not an independent institution as authority? Because B.N.R. proved to be a solid institution, with all bankruptcies recorded in Romania, which we may say were inevitable in a fragile economic environment in transition.

About the opportunity of instituting prudential rules specific to the banks for preventing financial risks at non-banking financial institutions level having in sight difficulty and even incapacity of adapting them to minimum social capital of 200.000 Euro equivalent, but also costs of prudential ruling, being proved the fact that these are transferred over clients, we have a simple answer through functioning (and crises) in Romania of others financial institutions, namely credit cooperatives.

Credit cooperatives, called until 2000 "popular banks" functioned according legislation regarding organizing and functioning of consumption cooperation and credit cooperation, braking practically banking legislation that provided: " is forbidden to any person to develop banking activity on the territory of Romania without an authorization issued by National Bank of Romania"<sup>6</sup>. Not being covered by B.N.R. supervision in year 2000 some credit cooperatives were in impossibility to give back to people the

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<sup>5</sup>source: [www.bnr.ro](http://www.bnr.ro)



deposits, so is coming back over old law of cooperation, their performance being considerate performance under banking legislations, in this manner are defined some norms of bank prudentially for credit cooperatives<sup>7</sup>. According to new legislative framework popular banks were in the situation either to re-organize and affiliate to a central house of credit cooperatives (that guarantees integrally obligations of affiliated cooperatives) becoming credit institutions supervised by National Bank, or to change their juridical form and become commercial banks. We don't have to expect a crisis of one of financial institution category, to create prudential ruling and supervising framework.

We have to remark major difference between credit cooperatives as credit institutions that collect deposits and non-banking financial institutions that cannot collect deposits and cannot even to collect resources from capital market issuing bonds, according to new legislative framework. There are opinions of some specialists saying that is no need for banking rules for non-banking institutions, because in their case is not present un-payment risk these keeping property over acquired goods through leasing or mortgage credit, for example. Wrong! Whole ruling framework has as an objective protecting clients of financial institutions. Or, their bankruptcy would mean partial or total loss of sums paid as advance and installments for developing contracts in cases mentioned above (leasing, mortgage credit, real estate or even selling of goods with part payment). MTS Leasing case that brined losses for contract's beneficiaries, is relevant.

Obvious, objective of new rules is to enforce a higher degree of discipline in financial market framework, but final beneficiary must to be re-found at the level of service's clients offered by these non-banking financial institutions through a higher degree of insurance and protection felt by these; including authorization by B.N.R of these institutions, function of management's quality, has as a scope credibility and functioning efficiency increase.

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<sup>6</sup> Banking Law no 58/1998 – Official Monitor no 121/23.03.1998.

<sup>7</sup> Urgent Government Ordinance no 97/2000 regarding credit cooperates organizations – Official Monitor no 142/29.06.2000

Although, because a big part of societies under new legislative framework incidence do not have an important market quota is expected to produce mutations like fusions at non-banking financial institutions level, although B.N.R. never announced giving a period to fulfill conditions of these institutions.

Looking beyond ruling these institutions we can see an enlargement of banking system in Romania, because instituting B.N.R. supervising only difference between credit and non-banking financial institutions remains the one of un-constituting deposits by the last ones. More than that, for a part of these institutions, becoming credit institutions assimilated to banking system, is not excluded in the future the change of their statute; e.g. mortgage credit institutions (4 as a number in present), that can became mortgage credit banks (adapting to legislation, of course). Mortgage credit institutions were forced, since their creation<sup>8</sup>, to a social capital minimum 3 mil. Euro, elaborating of some own norms of crediting to comprise including prudential norms, constituting specific credit risks provisions and organizing accountancy accordingly some norms applicable to credit institutions, all these in conditions of B.N.R. notification of set up and future changes regarding mortgage credit society.

The same possibility exists in the case of consumption credit societies (21 as a number), commercial transactions funding societies (6 as a number) and even leasing societies case (261 as a number)<sup>9</sup> having in sight that beginning with 2007 banks will may develop directly leasing operations.

Until the possibility of enlargement banking system, we hope in an market reorganization, and also, we hope that supervising instituted will not transform in a formal or old-fashion control. The way in which different countries approached supervising and financial market's ruling problem constitutes an actuality subject in the perspective of harmonization with Basel II accord rules.

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<sup>8</sup> Urgent Government Ordinance no 200/2002 – Official monitor no 956/27.12.2005

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# THE IMPROVEMENT OF THE BUDGETING SYSTEM IN CONSTRUCTIONS

**Dr. Emil Chirila Oradea University**

*The strategy of the construction enterprises must establish the assembly of the long term major objectives (4-5 years), the resources allotted, as well as the main ways to obtain the competitive advantage, suitable to the size of the company.*

*The forecasts of the construction enterprises are achieved during different periods of time, distinguishing between:*

- *Strategic plans (5-10 years)*
- *Operational plans (2-5 years)*
- *Budgets (1 year)*

*The budget is considered as an instrument of correlation and efficiency of the relation between expenditure and earnings, and the budgeting, a systematic economic practice that assumes the performing of a formal process of financial resources allocation, in order to achieve some objectives established for the future.*

*The coherence of a budgetary system is ensured by complying with some principles:*

- *the totality principle*
- *the principle of overlapping the budgetary system on the authority system*
- *the principle regarding the maintenance of the solidarity among departments and of the concordance with the general policy of the company*
- *the principle of suppleness in an economic-social frame more and more loaded by constraints*
- *the principle of coupling with the personnel policy*

*The drawing up cycle of the budgets can be decomposed into four phases:*

- 1) the identification of the objectives of the enterprise;*
- 2) the drawing up of preparation studies regarding the production factors market and the sale market;*
- 3) the drawing up of pre-budgets;*
- 4) the drawing up and approval of the enterprise's budgets.*

The main objective of construction business companies consists in assuring *viability* in terms of internal and international competition in connection with sustainable developing, and the results of the activity are generated in financial indicators such as: profit, company's value, liquidity.

The strategy of building companies has to set all the major long term objectives (4-5 years), the assigned resources, but also the main means of achievement in view of obtaining the competitive advantage, suited to the size of the company.

Building companies' strategy consists in defining the general acting directions of developing axes, that the leadership wishes to follow in the next few years, and the strategic plan has to reconsider the main points of the strategy, such as:

- Resources: markets, activities, services, technologies;
- Company's objectives: the market figure, turnover, result;
- Means of attaining the objective: internal and external growth, geographical areas, the need of extra resources;

Building companies' planning is made on different terms, resulting the following categories:

- Strategic plans (5-10 years)
- Operational plans (2-5 years)
- Budgets (1 year)

Planning of financial indicators uses the following instruments:

- The income and expenses budget;
- The planning balance sheet;

- The financing table
- The cash flow board
- The projected dynamic of the main financial indicators

Today's practice at building companies sees the profit and loss account as the only document that involves planning, the balance sheet and the table for treasury flow being seen as reporting documents of the past financial situation

A performing management system imposes the building of balance sheet on the ground of the income and expenses budget and the cash flow predicted for the next period seeking response to the following:

- the external financing need on the set of using full (or partial) production capacity;
- the turnover level that does not require external financing;
- the profit range, holding the debts/own funds ratio constant;
- the possibility of retrieval the investment in due term
- the rotation rates (and other indicators) of future assets and liabilities.

Building projected financial situations implies going through the following steps:

- 1) Setting hypothesis regarding the given period.
- 2) Setting some financial indicators as requirement for control and margin threshold to frame them.
- 3) Compiling financial projected situations.
- 4) Checking the accomplishment of set requirements.

To explain financial planning models, we shall use the information gathered from annual situations of the budget report N (2004) and N-1 (2003) at CRISANA CONS SA ORADEA.

The legal planning model starts on the premises that for the planned year N+1 (2005), the planned inflation will be 7%, the profit tax rate will be 16%.

The simplified profit and loss account earned for the financial report year N (2004), approved by AGA (General Stockholders Convention), looks like this:

Turnover	206.000 million lei
Income	212.000 million lei
Expenses	184.200 million lei
Gross Income (Profit)	27.800 million lei
Tax	6.950 million lei
Net Profit	20.850 million lei

The profit distribution according to AGA decision:

Reserves (growing own financing sources)	14.805 million lei
Dividends	6.045 million lei

The company's simplified balance sheet for the financial report N-1 (2003) and N (2004) presented in the following table contains:

Balance sheet	N-1	N	Variations N-(N-1)
Gross assets	28.750	38.800	10.050
Total amortization	3.100	5.650	2.250
Net set assets	25.650	33.150	7.500
Stocks	2.122	5.545	3.423
Debt	20.626	68.470	47.844
Available	2.730	7.155	4.425
Circulating funds	25.478	81.170	55.692
Total assets	51.128	114.320	63.192
Own funds	36.084	53.390	17.306
Suppliers	14.344	51.260	36.916
Other debts	700	9.670	8.970
Total debts	15.044	60.930	45.886
Total liability	51.128	114.320	63.192

Considering the two consecutive periods we could compile the cash-flow for N (2004):

+Net profit	20.850
+Amortization	2.550
- Stock variation	3.423
- Debts variation	47.844
+Suppliers variation	36.916

-Other assets elements variation	-2.550
+Other liability elements variation	-3.169
<b>=cash flow from exploiting activities</b>	<b>8.430</b>
-Acquisitions from immobilizing	10.050
<b>=Cash-flow from investment activities</b>	<b>-10.050</b>
+Payment dividend	6.045
<b>=cash-flow from the financial activity</b>	<b>6.045</b>
Available to start with	2.730
<b>Total cash-flow</b>	<b>4.425</b>
Available at the end	7.155

Other assets elements variation: total assets variation – debts variation – stocks variation – funds variation – variation of available funds – fixed funds reception

$$63192 - 47844 - 3423 - 4425 - 10050 = -2250$$

Other liability elements variation: variation of total liability – profit – suppliers' variation – payment dividends – amortization expenses

$$63192 - 20850 - 36916 - 6045 - 2550 = -3169$$

Next phase sets the relevant indicators for financial planning, looking to obtain adequate values for the main financial and economic indicators in the next period. Thus is calculated the stocks rotation rate, the debts rotation rate, the circulating funds rotation rate and the suppliers' rotation rate for N (2004):

$$\text{Stock rotation} = (\text{St}/\text{CA}) \times 360 = 9.7 \text{ days} \sim 10 \text{ days}$$

$$\text{Debts rotation} = (\text{Cr}/\text{CA}) \times 360 = 119.6 \text{ days} \sim 120 \text{ days}$$

$$\text{Circulating funds rotation} = (\text{Acirc}/\text{Ca}) \times 360 = 141.85 \text{ days} \sim 142 \text{ days}$$

$$\text{Suppliers' rotation} = (\text{FN}/\text{CA}) \times 360 = 89.058 \text{ days} \sim 90 \text{ days}$$



The company wishes to bring the analyzed indicators in the N+1 financial exercise (2005) to these values:

Stock rotation	= 12 days
Debts rotation	= 90 days
Circulating funds rotation	= 120 days
Suppliers' rotation	= 45 days

For the year N+1 (2005), the projected profit and loss account looks like this:

Turnover	201120
Amortization	2915
Income	206230
Expenses	188747
Gross profit	17483
Tax	2797
Net profit	14686

Proposed distribution of the profit:

- own financing sources	12685
- dividends	2000
- investments	5000

Considering the planned profit and loss account, the values of circulating funds elements for N+1 (2005) shall be calculated by dividing the number of days a year has to the desired number of days for one rotation, thus obtaining a rotation coefficient. Relating the turnover to the coefficient obtained as described, the circulating funds elements' value will result as follows:

N+1	
Stocks N+1 = 360/12=30	201120/30=6704
Debts N+1 = 360/90=4	201120/4=50280
Suppliers N+1 = 360/45=8	201120/8=25140
Circulating funds N+1 = 360/120=3	201120/3=67044

Availability = circulating assets – debts = 67044-50280-6704=10060

Net immobilized assets = net assets+investments=38800+5000=43800

Amortization N+1 = amortization N+ provisioned amortization N+1=  
=5650+2915=8565

Net assets = Immobilized gross assets – amortization = 43800-8565=35235

Circulating assets=67044

Assets = 35235+67044=102279

CP = CP (N) + profit redistribution N+1=53390+12685=66075

Total debts=Total assets – CP=102279-66075=36204

Other debts = total debts – suppliers = 36204-25140=11064

The result account provisioned on the financial report N+1 can now be defined and variations to accomplish cash-flow are set. Company's balance sheet for the year N+1, variations

Balance sheet	N+1	N	Variations (N+1)-N
Gross assets	43800	38.800	5000
Total amortization	8565	5.650	2.915
Net set assets	35.235	33.150	2.085
Stocks	6704	5.545	1.159
Debt	50.280	68.470	-18.190
Available	10.060	7.155	2.905
Circulating funds	67.044	81.170	14.126
Total assets	102.279	114.320	-12.041
Own funds	66.075	53.390	12.685
Suppliers	25.140	51.260	-26.12
Other debts	11.064	9.670	1394
Total debts	36.204	60.930	-24.526
Total liability	102.279	114.320	-12.041

Cash-flow provisioned for the year N+1:

+Net profit	14686
+Amortization	2.915
- Stock variation	1.159
- Debts variation	-18.190
+Suppliers variation	-26.120
-Other assets elements variation	-2.915
<u>+Other liability elements variation</u>	<u>-5.522</u>
<b><u>=cash flow from exploiting activities</u></b>	<b><u>5.905</u></b>
<u>-Acquisitions from immobilizing</u>	<u>5000</u>
<b><u>=Cash-flow from investment activities</u></b>	<b><u>-5000</u></b>
<u>+Payment dividend</u>	<u>2.000</u>
<b><u>=cash-flow from the financial activity</u></b>	<b><u>2.000</u></b>
Available to start with	7155
<b>Total cash-flow</b>	<b>2.905</b>
Available at the end	10.060

Variation of other asset elements=  $-12041-1159-(-18190)-2905-5000=-2915$

Variation of other liability elements=  $-12041-14686-(-26120)-2000-2915=$   
 $= -5522$

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## **Monetary policy and financial developments**

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*Review: This work wants to briefly present the monetary policy and the financial developments in 2005 in Romania, focusing on the monetary policy, the interests rates evolution, the currency exchange rate evolution and cash flow, the domestic currency and the loan and also the inflation perspectives.*

### **1. Monetary policy**

The third quarter of 2005 was a special period for the central bank as regards the monetary policy strategy and tactics. In August, the NBR shifted formally to inflation targeting, the adoption of which had been prepared during the past 16 months. By adopting inflation targeting, the central bank assumed more clearly the task of consistently pursuing the fulfilment of its fundamental objective, its accountability for achieving the inflation target being more clearly expressed.

În the period under review, monetary policy had to deal with the tighter constraint from short-term capital inflows, which rose to an unprecedented level, and with the risk of an increase in such inflows. The central bank undertook strenuous efforts to reconcile the need of minimizing this threat in the short run with the goal of ensuring sustainable disinflation in the medium and long run. For this purpose, the NBR adopted and implemented an adequate mix of monetary policy, prudential, as well as some administrative measures, the last two categories being meant to preserve financial stability and enhance the effectiveness of monetary policy instruments with a view to achieving and maintaining price stability. Under the impact of these measures, the broadly-defined monetary condition, including the

developments in interest rates, exchange rate of the domestic currency and liquidity across the economy, have remained on course to achieve medium-term disinflation. The third quarter of 2005 witnessed extremely challenging macroeconomic conditions from the perspective of monetary policy conduct; the central bank had to deal with the still overly rapid growth rate of domestic demand, on the one hand, and the impact of the strong resurgence in speculative capital inflows on the domestic financial market, on the other; another matter of concern was the risk of worsening of inflation expectations against the backdrop of persistently unfavourable impact of some of the supply-side factors (the increase in fuel price) on consumer price index, which made the central bank revise the year-end inflation target to 7,5 percent.

The still fast growth of domestic demand in Q2 – despite the decline in self-consumption – and, especially, the developments in some relevant indicators in Q3 pinpointed the persistence of pressures exerted by the rapid increase of domestic absorption on the main macroeconomic equilibria. According to statistical data, the main driver of this growth was further household consumption; thus, July through August, sales of most market goods and services posted annual average rises relatively higher than in 2005 Q2. During the period, the high growth of private consumption was steadily fostered by fast upward trend of household disposable incomes as a result of: (i) the sharp increase in net real wages (their average annual growth rate went up to 14,2 percent during July-August, compared with 13 percent in Q2); (ii) the increase in remittances from Romanian workers abroad to a record high (due also to seasonal factors); and (iii) the rise in the number of employees economywide.

The effect of higher incomes on household consumption was enhanced by that of changes in household behaviour in the last few years; thus, heavy resort to bank and non-bank loans by individuals as well as further decline of the annual real growth rate of household savings with banks may suggest that individuals chose to increase current consumption to the detriment of future consumption, which contrasted with

the behaviour prevailing in the past years. During July-August, the average annual growth rate (in real terms) of balance of household loans rose to 62,2 percent (compared with 53,1 percent in Q2 and 43,4 percent in Q1). This development was mostly driven by consumer loans, the real average annual growth rate of which (77,9 percent) outpaced by far that recorded in the previous quarter (61,2 percent). Although the growth pace of foreign currency-denominated consumer loans slowed, they continued to be the fastest—growing component of consumer loans (annual increase of 303,6 percent compared with 403,1 percent in the previous quarter) given that lending terms were seen as being more affordable. The rise was also underpinned by promotional banking products provided by a large number of credit institutions interested in explaining their market share, the relatively attractive supply of some of the banking products being supported by resources of the parent banks.

Behind the strong domestic demand during the period under review stood also the higher growth rate of private sector investment, bolstered by large inflows of funds. Thus, July through August, long-term credit rose at a real average annual rate almost similar to that record in the previous quarter, with the annual rate of increase of leu-denominated loans being two times higher than in 2005 Q2. The average monthly volume of medium-and long – term foreign credits to non-bank sector increased by eur 203 million (EUR 187,3 million in the previous quarter). Pressures exerted by excess domestic demand – to which external financing contributed significantly, further fed mostly thorough into the trade deficit, whose widening slowed down only slightly July through August, compared with the previous quarter.

Inflows of potentially volatile capital were much higher in 2005 Q3. The inflows of speculative capital increase starting July, due mainly to (i) the still high interest rate differential between domestic and world markets, (ii) the expectations of further nominal appreciation of the leu against the euro, due also to the expected flexibilisation of the exchange rate regime following the shift to inflation targeting

and (iii) the possible decrease of sovereign risk premium. Large inflows of volatile capital brought about the surge of transactions performed by bank clients of the interbank forex market to monthly record highs and, especially, the expansion of the bank balance of non residents' leu-denominated time deposits (a more than threefold increase in August). The adverse direct effects of volatile capital inflows were mainly the strong increase of pressures of the exchange rate and rapid nominal appreciation of the leu as well as the expansion of surplus liquidity in the banking system and costlier sterilisation operations performed by the central bank, as part of the volatile capital was mopped up.

These macroeconomic conditions, which featured fast expansion of domestic demand financed from foreign borrowings, either directly by or via banks, on the one hand, and the increase of risks to macroeconomic equilibria and financial stability associated with the rise in volatile capital inflows, on the other, rendered the dilemma concerning the interest rate policy more difficult.

To the macroeconomic challenges added also the slightly slower disinflation (compared with the short-term forecast of the NBR) attributed mainly to higher-than-expected increase of prices for fuels and vegetables. In order to strike a balance between the need to strengthen its credibility by ensuring that the inflation target is met, on the one hand, and the need to increase the role of anchoring public expectation through the announced inflation target – on the other – both playing a more significant role in the context of the new monetary policy strategy – the central bank revised the year-end inflation target. Even under these circumstances, the persistence of pressures from high growth rates of prices for services as well as the likelihood of larger second-round effects of administered price adjustments due for the coming months on core inflation continued to pose a risk to keeping disinflation in line with the targeted trend.

In the context of major challenges stemming from economic conditions, the central bank decided to combine in a flexible and consistent manner to monetary policy, exchange rate, prudential and even administrative measures. During the first part of



the period under review in an attempt to prevent the economy from overheating, the central bank relied, to a larger extent, on the interest rate policy. Thus, after deciding to put a halt to key rates cuts in July, in August the NBR tightened further interest rate policy by raising the average effective interest rate on sterilisation operations to 8,5 percent – one of the benchmarks used by credit institutions in setting lending and deposit rates. Moreover, in order to enhance the transparency of the central bank and consistency of monetary policy decisions as well as a view to boosting the signalling role of interest rate- given the adoption of inflation targeting in August – the central bank decided to eliminate the departure between the policy rate and its effective sterilisation rate.

Nevertheless, over the period, the interest rate policy was affected by the restrictions deriving from the significant rebound in speculative capital inflows and by its scant efficiency which was ascribed to the large share of foreign exchange-denominated loans in non-government credit (59,4 percent in August); the two reasons underlay the central bank's decision to refrain from making increased resort to the interest rate policy. In order to tighten further the monetary policy and ensure better functioning of (RON-denominated) credit channel and interest rate channel, on the one hand, and to mitigate the risks that fast-paced foreign exchange-denominated loans posed to financial stability, on the other, in July the National Bank of Romania adopted a package of measures meant to: (i) gradually apply the 30 percent reserve ratio on all foreign – exchange liabilities, irrespective of their maturity and the date they had been raised, (ii) reduce to 16 percent from 18 percent the reserve ratio on RON-denominated liabilities with maturities of up to two years and (iii) amend the norms on containing household credit risk by tightening bank lending requirements.

At the same time, the central bank resumed its intervention in the foreign exchange market in an effort to deter volatile capital inflows by stifling expectations of steady strengthening of the domestic currency and by increasing the unpredictability of exchange rate movements. The record-high purchases in August notwithstanding ,

the domestic currency continues to strengthen (by 1,7 percent in nominal terms against the euro, after posting an appreciation of 1,4 percent in July).

Against the backdrop of still rising volatile capital flows, in spite of the implementing mix of measures, the National Bank of Romania decided to radically change its manner of approaching the macroeconomic context, by adopting the extreme solutions of easing the fact the interest rate policy. The daily average interest rates on bank's deposits with the central bank were lowered gradually in anticipation of the restrictive effects of (i) change to required reserves for foreign exchange deposits and (ii) the maintenance of policy rate at 8,5 percent. This decision was implemented via the liquidity policy, with the NBR starting in the latter half of August to gradually reduce the volume of surplus liquidity absorbed through one month deposit operations ; under the circumstances , credit institutions imported more frequently to the deposit facility , causing the average interest rate on both one-month deposits and the deposit facility to take a dive.

However, this measure was not efficient enough, as the interbank foreign exchange market still experienced noticeable rises in arbitraging operations; as a result, the NBR viewed the sharp cut in its key rates as a necessary step. Therefore, the central bank decided to lower the policy rate to 7,5 percent the interest rate on the lending facility to 14 percent and the interest rate on the deposit facility to one percent, the same level applied by the ECB. Moreover, the NBR continued to mop up only part of the liquidity surplus, whereas the banks' heavier resort to the deposit facility led to a sharp decline in the average interest rate on bank deposits with the NBR (5,2 percent in September). The market reacted swiftly to these decisions ; capital inflows ceased to grow while the domestic currency appreciations came to a halt, posting a trend reversal towards end-September.

In an attempt to mitigate the effects the looser interest rate policy and on liquidity in the economy and to improve non-government credit structure in order to support financial stability, the NBR Board decided in September to take some administrative measures with a view to containing the expansion of foreign

exchange – denominated loans . The measures consisted in limiting the exposure of credit institutions to at most 300 percent of its own funds when granting foreign exchange-denominated loans to unhedged borrowers, natural and legal persons (entailing credit risk for the credit institutions acting as lenders).

## **2. Financial markets and monetary developments**

The unexpectedly strong increase in volatile capital inflows and the manner in which the NBR attempted to consolidate monetary stability and preserve banking system soundness had a heavy impact on monetary conditions in 2005 Q3. The RON saw stronger nominal appreciation against the EUR, while short-term interest rates went down , their trend sharpening at the end of the considered period . Money demand was further robust, while the growth rate on non government credit accelerated particularly on the back of the fast increase in household loans.

### **2.1. Interest rates**

Given the specific liquidity conditions and the frequent and sizeable change to the central bank's interest rates, the interbank deposit rates followed a downtrend July through September, with occasionally rapid and sharp downward adjustments.

Thus, after remaining relatively stable in July, in the latter half of August, interbank deposit rates witnessed a plunge as a result of the NBR's decision to stop siphoning off entirely the liquidity surplus via one-month deposit-taking operations. The significant cut in the volume of deposits taken by the monetary authority coupled with the rise in excess reserves in the banking system, following the NBR's purchases of foreign exchange in the considered period, on the one hand, and with the slight drop in demand for liquidity, on the other , led to an unprecedented increase in bank's resort to the deposit facility. Against this background, daily interbank deposit rate plummeted, moving gradually away from the policy rate and nearing the floor of the corridor defined by the standing facility rates. The decline in interest rate sharpened in September amid the step-up in liquidity surplus and the fall in the deposit facility rate; in September, the average interbank rate depped by 4 percentage points from June to 3,4 percent.

Following the increase in both the liquidity surplus and interbank market uncertainty, interbank deposit rates on overnight transactions fell occasionally even below the deposit facility rate, fluctuating in a wider range (between 1,1 percent and 7,6 percent). Under the impact of the same factors, the volatility of overnight rates rose gradually, hitting a record high in September.

The pick-up in liquidity surplus caused the interbank market to lose depth, with the average volume of interbank transactions decreasing 18,3 percent quarter on quarter. In month-on-month comparison, the loss of depth was the more so obvious considering that the average flow of deposit in September accounted for only 47,4 percent of the June flow.

1M-12 M BUBOR yield curve posted a faster decline, showing however a flattening trend. Average overnight and one-week BUBOR rates fell even more sharply, their monthly average standing 3 percentage points lower at end September, compared to the end of June; as a result, the spread between monthly average of 12-month BUBOR rate and overnight BUBOR rate widening again, from 1.6 percentage points in June to 3.6 percentage points in September. The spread between overnight BUBOR rate and effective interest rates on overnight transactions rose by 0,2 percentage points.

Similar to the previous quarter, forward rates, calculated on the basis of September quotations, indicate that interbank rates will remain unaltered in the following three months (3-month BUBOR rate is expected to reach 7,8 percent in December, staying almost flat compared with Q3). For March and June 2006, 3-month BUBOR rate is anticipated to move down by 0,4 percentage points and 0,6 percentage points respectively, compared to the level for December 2005. According to the NBR's monthly survey, the 12-months BUBOR rate is expected to drop half of a percentage point in October and one percentage point by October 2006 (compared with the level recorded at end-September 2005).

Unlike interbank rates, interest rate on the primary market for government securities fell steeply only in September, down 1,7 percentage points on 3-months T-bills and

1,1 percentage points on 3-years bonds. By contrast , interest rates on newly – issued government securities flattened out somewhat in July and August after edging up in the previous quarter.

In September, the fall in interest rate on government securities was fostered by strong demand of market participants for government paper, on the one hand, and by the low volume of government securities on offer, on the background of further surplus in the Treasury's account, on the other. As a matter of fact, this surplus allowed the Ministry of Public Finance to make net redemption of roughly RON 63 million, i.e. the entire amount projected to be redeemed.

In the quarter under review, the Ministry of Public Finance issued particularly government securities with maturities of 3,5 and 10 years and only to a small extent 3-month Treasury certificates; the interest rates on the newly – issued securities ranged between 5,4 percent and 8 percent.

Unlike other categories of interest rates, the interest rates applied by banks to non-bank non-government clients decreased at a slower pace June through August 2005. The development was illustrative of the fact that the NBR interest rates cuts over the first half of the year no longer acted as an incentive. The drop in the average interest rate on deposits with the central bank in September is seen to gradually feed through to the interest rates applied by credit institutions, which are expected to move down faster in the coming months.

In 2005 Q3, the average interest rate on new time deposit went down 0,4 percentage points, while that on new loans declined by one percentage point. In the latter case, the steeper decrease was due to the 1,3 percentage point drop in the interest rate on loans granted to legal entities, possible as a result of stiffer competition. By contrast, the smaller adjustment of interest rates on time deposits made be attributed to the relative sensitiveness of some credit institutions (holding a large share of household savings) to the NBR officials' statements on the maintenance of interest rate at attractive levels for depositors.

## **2.2. Exchange rate and capital flows**

Approaching the adoption of direct inflation targeting was one of the catalysts for the occurrence of the effects of April liberalisation of non-residents' access to leu-denominated time deposits. Starting July, capital inflows increased sharply, leading to record high turnover on the interbank foreign exchange market, which exceeded by far the previous quarter's readings, and to an unprecedented increase in pressures on the exchange rate of the domestic currency.

On this background, in July and August, the nominal appreciation of the domestic currency against the euro accelerated significantly. Towards the end of Q3, interbank forex market conditions changed markedly, causing the fall of RON/EUR rate to come to an end and leading subsequently to a trend reversal thereof; nevertheless, the domestic currency appreciated by 3 percent in nominal terms versus June (- 4,7 percent in real terms). In the quarter under review, the RON strengthened by 3,6 percent in nominal terms against the USD (5,3 percent in real terms), regaining part of the ground lost in the previous 3-month period. Calculated as annual average change for the third quarter, the domestic currency strengthened further against the EUR (16,2 percent in nominal terms and 26,5 percent in real terms), slowing however its appreciation against the USD (16 percent in nominal terms and 26,3 percent in real terms).

The mounting pressures on the exchange rate of the RON stemmed from the very high levels of oversupply on the foreign exchange market in the first two months of the third quarter, fuelled by short-term capital inflows which reflected nonresidents' keener interest in acquiring RON-denominated assets (see Section 1. Monetary Policy). Seasonal factors, such as the pick-up in the volume of remittances from abroad, the rise in receipts from tourism, as well as the lower demand for the foreign currency to make payments on external private debt also contributed to the step-up in the foreign currency surplus on the forex market. Moreover, forex market supply was fed by part of the financial flows which were specifically aimed at bridging the higher trade deficit or at meeting the higher level of required reserves in foreign exchange by banks. July through August, capital

inflows went up against the background of : (i) the 4,4 time expansion in non-resident banks' deposits compared to the previous quarter; (ii) the sales of foreign securities by resident banks, amounting to EUR 333 million in July and EUR 368 million in August; (iii) the still high volume of foreign loans taken by banks and corporate sector. On the other hand, the EUR 500 million-worth of funds raised by Bucharest Mayorality at end-June following the bond issue in Luxembourg had no impact on the foreign currency supply in the interbank forex market.

In an attempt to dampen volatile capital inflows and to put a halt to the excessive appreciation of the RON, in July-August period, the central bank purchased a record high volume of foreign currency on the forex market. Starting with the latter half of Q3, the NBR eased the liquidity policy and the interest rate policy in an effort to reduce arbitraging opportunities. Even though it became less predictable, in August, the RON/EUR exchange rate continued to decline steeply. However, in September, the downward trend came to a halt and the exchange rate moved up, due to re-emergence of forex deficit on the interbank market, causing the RON to soften 0,1 percent in nominal terms. The drop in foreign exchange supply towards the end of Q3 was mainly due to the declining short-term capital inflows following the decrease in NBR interest rates and interbank rates, as well as to the fact that investments on other markets became more profitable. The seasonal drop in remittances also contributed, to a lesser extent, to the contraction in total foreign exchange sales.

In the coming months, amid further lowering pressures from volatile capital inflows, the scope of influence of the traditional determinants of the exchange rate path is expected to broaden; in this respect, in the short run, the following developments will prevail: (i) possible widening of the trade deficit; (ii) increase in payments on external private debt; and (iii) pick-up in the volume of remittances in December. Some of the effects of the said developments were already manifest in October, when the domestic currency depreciated at a faster pace against the euro.

### **2.3. Money and the credit**

## Money

In June-August 2005, money demand remained robust, the growth rate (30,4 percent) of broad money (M2) slowing only slightly compared to previous months' record values. The expansion was largely due to the same factors as in the previous period (foreign capital inflows, including those associated with privatisation proceeds, increase in non-government credit and the change in households' financial asset portfolio structure); the impact of rising public spending during the reported period added to the above-mentioned factors.

However, the structure of M2 witnessed a relative worsening, as a result of the non-bank sector's increased propensity for holding liquid monetary assets. Whilst narrow money (M1) rose at one of its fastest rates in the last decade, quasi-money dynamics slowed; under these circumstances, the share of M1 in broad money peaked at 25,8 percent, a record monthly average for the past 7 ½ years. Demand deposits remained the fastest growing component of narrow money, as their rise was driven mainly by the low opportunity costs as well as by certain incidental factors. On the other hand, the increase in currency outside banks followed a relatively stable path, except for June, ahead of the upcoming domestic currency redenomination.

Composition of broad money by currency continued to improve, with the share of forex deposits in M2 touching its lowest monthly average in the last 6 ½ years, i.e. 32,9 percent.

The growth of household deposits continued to slow down during the reported period. This was the result of the deceleration in the growth of savings (in both domestic and foreign currencies) that occurred despite the accelerated growth in disposable incomes of households (against to background of the increase in wages and remittances from abroad) and the contraction in government securities portfolio held by individuals. Given the drop in interest rates on time deposits, the sharper decline in leu-denominated savings of households was associated with unprecedented increase in their current account.



The growth rate of corporate deposit also slowed, given that the change in leu-denominated time deposits stayed on downward drift, while the change in forex deposits resumed the downtrend in July. The slower pace of increase incorporate forex deposit was caused by the transfer of privatisation proceeds to the MPF account and by the potential impact (still at an early stage) of liberalisation of residents' access to opening accounts abroad. On other hand, the following inflows were channelled to the companies' accounts: (i) transfers representing capital increases of newly-privatised companies, (ii) changes in non-bank clients' financial asset portfolios (the stock of government securities fell 15,6 percent in real terms during the reported period), and (iii) budget appropriations for the rehabilitation of houses and infrastructure hit by natural calamities.

### **Non-government credit**

The growth rate of non-government credit continued to gain momentum June through August 2005 (26,4 percent, the highest monthly average so far this year), reflecting the faster increase in household loans. The main drivers of this development were the increase in household incomes and the strengthening of the domestic currency, on the one hand and the keener competition among credit institutions, mirrored by relatively low interest rate and a large range of banking products, on the other hand, against the background of a pick-up in banks' borrowings and deposits from abroad; under one-off factor that must likely spurred lending during the reviewed period was the fact that borrowers sought to avoid the tighter conditions imposed by the entry into force of the new norms on lending.

The structure of non-government credit by currency reveals a steady upward trend in leu-denominated loans and the commencement of a deceleration in the growth of forex-denominated loans (expressed in EUR). Thus, the share of foreign exchange-denominated loans in total loans witnessed a decline, yet it stayed high (59,7 percent, on average, during the period under review), whereas the spread between the growth rates of forex and leu-denominated loans narrowed steadily. It is quite

likely that, towards the end of the period, this trend also reflected the impact of changes to required reserves.

By borrower, loans to households continued to grow faster, their rate outpacing that of corporate loans. Long-term loans in domestic currency households rose most rapidly due to the relatively low interest rates on real estate and mortgage loans. Nonetheless, demand for consumer loans remained very strong, such loans accounting for 74 percent, on average, of total loans; however, in the case of this category of loans, a gradual rise in the households' preference for foreign-denominated loans was manifest.

The annual inflation rate was 8,6 percent at the end of 2005. The upward revision of the August projection (7,5 – 8 percent) was due to larger than expected increases in oil and food prices, as well as a higher forecasted exchange rate of the RON against the euro for the fourth quarter of 2005. In our opinion, disinflation is projected to continue through 2006, supported by the gradual reduction of the excess demand on the favorable influences of the RON exchange rate on import prices. It is nevertheless expected that the substantial adjustments projected for administered prices, along with a temporary slowdown in the reduction of inflation expectations in the first part of 2006, will push the year-end inflation close to the upper bound of the target band or even to overflow it with one percent.

The main risks of deviations from the projected inflation path could be generated by: new significant hikes in world oil and gas prices, increases in administered prices which may differ in terms of magnitude and timing from the forecast assumption, substantially different exchange rate dynamics as well as less prudent fiscal and wage policies than assumed in the baseline scenario.

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## SOME CONSIDERATIONS RELATED TO THE COST OF THE CAPITAL

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*The cost of the capital always remains a problem in discussion, living behind concepts and also considerations which don't wander us from the truth, but on the contrary, helps us to understand much deeply the economic realities.*

*In this study, I started from the reason that it would be necessary to present the cost of the capital taking into consideration not only the capital pattern but also the financial pattern.*

*In this context, I took into analysis a Commercial Bank Society.*

In the table no 1.A. the main indicators are reproduced, with witch we will operate for the determination of the cost of the capital, respectively social capital, intrinsic capital, necessary operating capital, total capital, net profit and distributed dividends.

**Table 1.A**

mii lei ROL      lei RON

No.	Indicators	Period				
		2001	2002	2003	2004	2005
<b>1.</b>	<b>Social capital</b>	<b>200.000.000</b>	<b>440.000.000</b>	<b>600.000.000</b>	<b>1.200.000.000</b>	<b>120.000.000</b>
2.	Premiums related to the capital	903.676	-	-	-	-
<b>3.</b>	<b>Provisions</b>	<b>199.324.715</b>	<b>339.132.274</b>	<b>358.814.680</b>	<b>388.532.455</b>	<b>45.490.404</b>
3.1.	Legal provisions	110.056.927	164.784.362	208.926.047	211.863.839	45.490.404
3.2.	General provision for the credit risk	16.222.061	29.129.248	38.190.398	64.970.381	-
3.3.	Other provisions	73.045.727	145.218.664	111.698.235	111.698.235	-
4.	Provisions from reassessment		17.089.096	19.754.054	19.754.054	-
5.	Funds	53.863.349	-	-	-	-
6.	Differences from reassessment	15.338.065	-	-	-	-
7.	Advances on the costs for risks and charges	-	51.929.052	35.710.986	-	223.335
7.1.	Other advances on the costs	-	51.929.052	35.710.986	-	223.335
<b>8.</b>	<b>Intrinsic capital</b>	<b>469.429.805</b>	<b>848.150.422</b>	<b>1.014.279.720</b>	<b>1.608.286.509</b>	<b>165.713.739</b>
9.	Debts on medium and long term	32.276.981	85.718.629	64.770.589	58.648.295	4.992.935
10.	Afferent interests	4.474.609	10.440.290	4.546.925	4.680.492	186.707
11.	Commissions	207.898	509.801	330.640	189.864	9.433
<b>12.</b>	<b>Necessary operating capital</b>	<b>506.389.293</b>	<b>944.819.142</b>	<b>1.083.927.874</b>	<b>1.671.805.160</b>	<b>170.902.814</b>
13.	Debts on short-term	1.465.893.588	2.254.434.288	3.459.494.950	5.226.090.925	883.405.981
14.	Afferent interests	202.683.228	285.318.634	233.511.959	409.522.378	32.004.174
15.	Commissions	9.416.990	13.932.143	16.980.331	16.612.263	1.617.021
<b>16.</b>	<b>Total capital</b>	<b>2.184.383.099</b>	<b>3.498.504.207</b>	<b>4.793.915.114</b>	<b>7.324.030.726</b>	<b>1.087.929.990</b>
17.	Net profit	155.216.672	220.093.277	180.898.754	92.042.900	19.818.171
18.	Distributed dividends	60.000.000	91.664.000	127.695.920	62.325.125	7.247.032

Starting from the Gordon-Shapiro formula, we can calculate the cost of the intrinsic capital:

$$P_A = \frac{D_t}{r-g} \Rightarrow r = \frac{D_t}{P_A} + g$$

For 2001,  $r = \frac{7.500}{25.000} + 11.902 = 11.902,3$  lei/sher. We apply the same method for the years 2002, 2003, 2004 and 2005; the resulted information are given in the table 1.B

**Table 1.B**

No.	Indicators	Period				
		2001	2002	2003	2004	2005
1.	Number of shares	8.000.000	17.600.000	24.000.000	48.000.000	48.000.000
2.	Nominal value (P <sub>A</sub> )	25.000 lei ROL	25.000 lei ROL	25.000 lei ROL	25.000 lei ROL	2,5 lei RON
3.	Dividend/Share	7.500 lei ROL	5.208 lei ROL	5.320 lei ROL	1.298,4 lei ROL	0,15 lei RON
4.	Net profit /Share	19.402 lei ROL	12.505 lei ROL	7.537,4 lei ROL	1.917,5 lei ROL	0,4128 lei RON
5.	g	11.902 lei ROL	7.207,37lei ROL	2.216,78 lei ROL	619,12 lei ROL	0,2618 lei RON
6.	r	11.902,3lei ROL	7.207,2 lei ROL	2.216,99 lei ROL	619,17 lei ROL	0,3218 lei RON
7.	r %	47,60	28,82	8,86	2,47	12,87
8.	g%	61,34	57,63	29,41	32,28	63,42

The cost of the intrinsic capital is given by the profitability rate claimed by shareholders who, in this context, is between 2,47% and 47,60%; rate of capitalization of the profit is between 29,41% and 63,42%.

Hereinafter we determine the cost of the outside capital on medium-term and long-term. This cost is given by the suitable rate of interest and bank commissions cumulatively.

**Tabelul 1.C**

No.	Indicators	Period				
		2001	2002	2003	2004	2005
1.	Rate of interest (r <sub>d1</sub> )%	13,86	12,17	7,02	7,98	3,73
2.	Rate of commission %	0,64	0,59	0,51	0,32	0,18

The cost of the outside capital is between 3,73% and 13,86%, this being given by the rate of interest and by the additional elements, respectively commissions between 0,18% and 0,64%.

If we know the two costs, we determine the weighted cost-average of the capital:

$$\bar{c}_1 = \frac{c_{pr}}{c_{pr} + c_{\hat{i}}} \times r\% + \frac{c_{\hat{i}}}{c_{pr} + c_{\hat{i}}} \times r_{d1}\%$$

Thus, in 2001:

$$\bar{c}_1 = \frac{469.429.805}{469.429.805 + 32.276.981} \times 0,476 + \frac{32.276.981}{469.429.805 + 32.276.981} \times 0,1386 = 45,42\%$$

According to this calculation algorithm in 2002  $\bar{c}_1 = 27\%$ , in 2003  $\bar{c}_1 = 8,74\%$ , in 2004  $\bar{c}_1 = 2,66\%$  and in 2005  $\bar{c}_1 = 12,59\%$

Taking into consideration the fact that short-term debts have a continual characteristic, it is essential to determine the cost of those. The results are presented in the table 1.D.

**Table 1.D**

No	Indicators	Period				
		2001	2002	2003	2004	2005
1.	Rate of interest ( $r_{d2}$ ) %	13,82	12,65	6,74	7,83	3,62
2.	Rate of commission %	0,64	0,61	0,49	0,31	0,18

Hereinafter we determine the cost-average of the capital, taking into consideration, this time, the short-term debts which had a continual characteristic.

$$\bar{c}_2 = \frac{c_{pr}}{c_{pr} + c_{i_1} + c_{i_2}} \times r\% + \frac{c_{i_1}}{c_{pr} + c_{i_1} + c_{i_2}} \times r_{d1}\% + \frac{c_{i_2}}{c_{pr} + c_{i_1} + c_{i_2}} \times r_{d2}\%$$

For 2001 the weighted cost-average of the capital is:

$$\bar{c}_2 = \frac{469.429.805}{1.967.600.374} \times 0,476 + \frac{36.959.488}{1.967.600.374} \times 0,1386 + \frac{1.677.933.806}{1.967.600.374} \times 0,1382 = 21,86\%$$

Following the same calculation algorithm in 2002  $\bar{c}_2 = 16,92\%$ , in 2003  $\bar{c}_2 = 7,21\%$ , in 2004  $\bar{c}_2 = 6,56\%$  and in 2005  $\bar{c}_2 = 5,06\%$ .

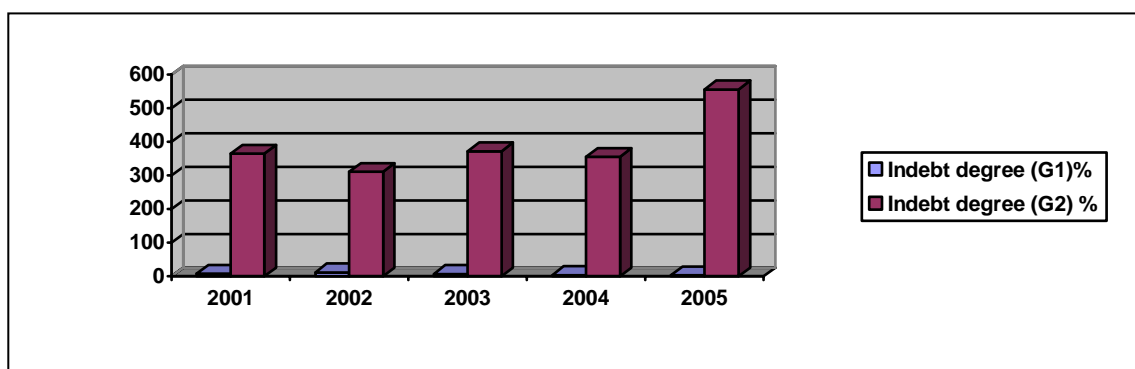
We present the previous information in the table 1.E. In this table are calculated the indebt degrees (medium-term and long-term indebt and the medium-term, long-term and short-term indebt)

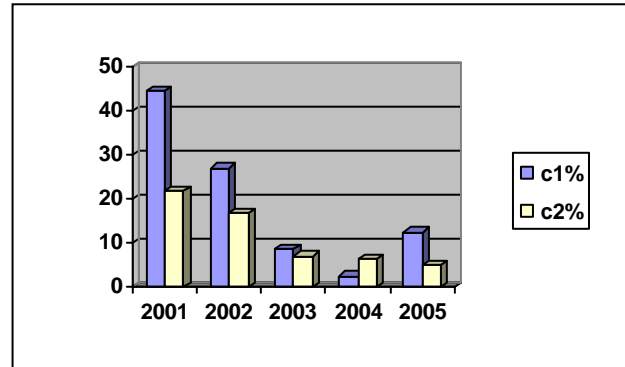
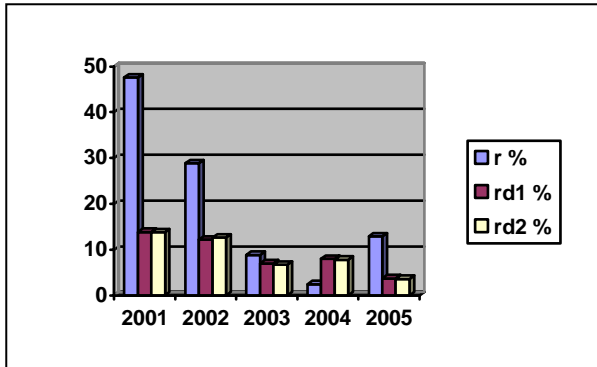
**Table 1.E**

No.	Indicators	Period				
		2001	2002	2003	2004	2005
1.	Indebt degree ( $G_1$ ) %	7,87	11,39	6,86	3,94	3,12
2.	Indebt degree ( $G_2$ ) %	365,32	311,42	372,64	355,39	556,51
3.	r %	47,60	28,82	8,86	2,47	12,87
4.	$rd_1$ %	13,86	12,17	7,02	7,98	3,73
5.	$rd_2$ %	13,82	12,65	6,74	7,83	3,62
6.	$\bar{c}_1$ %	44,42	27	8,74	2,66	12,59
7.	$\bar{c}_2$ %	21,86	16,92	7,21	6,56	5,06

The indebt degree  $G_1$  had been calculated as a division between the medium-term and long-term debts and the intrinsic capital; the indebt degree  $G_2$  as a division between the sum of debts and the intrinsic capital.

The determinations from the tables: 1A-1E is graphically represented below:





Some considerations must be underlined:

- the intrinsic capital has the highest cost;
- there are no major value differences between the cost of outside capital on the medium and long term and the cost of outside capital on the short-term;
- indebt degree on medium and long term is decreasing and the indebt degree on short-term is increasing; thus, the bank society prefers a short-term indebt;
- weighted cost-average is calculated taking into consideration the economy tax;
- during the entire analysed period 2001-2005, the three elements of the cost of the capital ( $r$ ,  $rd_1$ ,  $rd_2$ ) had suffered important diminution. Thus “ $r$ ” from 47,60% to 12,47%,  $rd_1$  from 13,86% to 3,73% and  $rd_2$  from 13,82% to 3,62%. All these in the context of the great increase of the indebt degree  $G_2$  from 365,52% to 556,51%;
- the capital cost is determined by the rate of discounting, rate which implies an estimation of the profitableness claimed by shareholders and of the rate of the interest “supervised” by the National Romanian Bank;
- in the case of the  $G_1$ 's increase in the context of the growing claim of the credit, we can estimate an increase of  $rd_1$  and  $rd_2$ , simultaneously with a decrease of “ $r$ ”. Simultaneously with the interest's increase, even if there is tax economy, the costs will diminish the incomes, as a conclusion, the gross and net profit;
- „ $r$ ” wouldn't diminish so much if the state didn't act through fiscal policy as it happens very often (example: the decrease of the tax on profit from 40% to 25% and to 16%);
- When the entity uses intrinsic and outside stocks, it is necessary to determine weighted cost-average and the marginal cost of the capital.
- Starting from the information obtained in the determination of the cost of the capital between 2001 and 2005, an estimation of this for a future period (2006-2010) means the usage of probability calculations, prognosis. Up to the present, the social capital (120.000.000 lei RON, between 2001 and 2005) had a cost defined through distributed dividends of 41.415.536,5 lei RON and the profit reinvested from its remaking was 84.643.331,3 lei RON.

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# LES RESPONSABILITES DE L'ETAT EN MATIÈRE FISCALE

**Conf. univ. dr. Ioan Dan Morar, Universitatea din Oradea**

Le pouvoir financier de l'Etat s'exerce dans un cadre institutionnel, et est soumis à des procédures dont les justifications sont à la fois politiques et technique.

Les lois de finances sont votées par le Parlement, préparées et exécutées par le Gouvernement, et assurent une répartition des rôles entre le deux pouvoir.

S'action financière de l'Etat est donc soumise à des formes, encadrée par des procédures, et mise en œuvre par des acteurs politiques et administratifs.

Elle repose aussi sur un ensemble de mécanismes, particulièrement complexes dans un système comme le nôtre où public et privé sont étroitement imbriqués.

Le Trésor et la Banque Nationale jouent au sein de ces mécanismes un rôle prépondérant. Enfin, au cœur de l'action financière de l'Etat il y a nécessairement le pouvoir fiscal, instrument privilégié de l'action de l'Etat, mais aussi reflet de la société elle-même, de ses structures comme de son inconscient.

L'Etat, a toujours assumé des responsabilités particulières vis-à-vis de l'économie. Cette présence de l'Etat s'est diversement manifestée selon les épargnes et selon la nature des instruments utilisés.

Les finances publiques contemporaines, nées des crises, des guerres, et de l'évolution de la demande sociale elle-même, sont caractérisées par un changement de dimension qui a transformé leurs rapports avec l'économie générale.

L'Etat, au plutôt l'ensemble des collectivités publiques, influe ainsi directement et massivement sur l'efficacité de notre l'économie, sur la structure des biens mis à notre disposition, et sur la répartition des richesses.

Ce changement de dimension des Finances Publiques se manifeste sans deux aspects. Un aspect quantitatif d'abord : le poids financier de l'Etat et de ses composantes par rapport au P.I.B. a considérablement augmenté. Un aspect



quantitatif ensuite : ce n'est pas seulement le volume des flux financiers publics qui s'est accru, mais c'est aussi leur contenu qui s'est transformé.

Des dépenses d'un type nouveau se sont développées, et répondent à des objectifs qui ne sont pas tous économiques, mais qui ont tous des incidences économiques. Durant les décennies qui ont suivi la seconde guerre mondiale tout s'est passé comme si les Etats occidentaux, tout en inscrivant leur politique et financière dans le cadre théorique de l'économie de marché s'étaient, en réalité par des interventions de toute nature, efforcés de modeler le marché selon leurs préférences.

L'Etat était ainsi devenu l'instrument privilégié de régulation de l'économie.

L'expérience a, d'autre part, montré à quel point était simpliste l'idée selon laquelle la micro-économie pouvait être réduite à la condition de serviteur passif d'une macroéconomie orientée et dirigée par l'Etat. Les dépenses publiques, la fiscalité, la monnaie et le crédit ne sont pas les seuls déterminants de l'économie, quelle que soit leur importance stratégique : les décisions prises au sein de la microéconomie, les réactions qu'engendre toute modification des règles du jeu par l'Etat, les relations entre les différents acteurs privés, nationaux et internationaux, affectent profondément et rapidement l'économie globale, et sont susceptibles de déjouer ou d'accumuler les projections faites au niveau de l'Etat.

Mais ce n'est pas seulement l'efficacité de l'intervention de l'Etat qui a été contestée, notamment sans ses aspects financiers, mais aussi la légitimité même de cette intervention. A des degrés divers, dans tous les Etats occidentaux, le rôle de l'Etat n'est important.

Mais l'idée que c'est le marché, et non l'Etat, qui est l'instrument global de régulation de l'économie fait désormais l'objet d'un large consensus.

Cette idée a en deux conséquences : elle s'est traduite, tout d'abord, par la volonté de mettre fin à la gestion administrée de l'économie ; elle a fait aussi sentir ses effets au sein de l'Etat lui-même qui, au moins dans certains domaines, s'est aligné sur les principes de l'économie de marché.

A l'époque contemporaine le désengagement de l'Etat, s'est opéré de plusieurs façons : la plus spectaculaire a été le mouvement de dénationalisations que a affecté

les économies occidentales, l'Etat a, d'autre part, très largement cessé de protéger du marché et la politique industrielle.

Les mesures fiscales soient votées par le Parlement, la technicité de l'impôt et le fait qu'il constitue un sujet particulièrement risibles, font que le Gouvernement garde la haute main sur l'imitation des projets et par conséquent sur la décision fiscale. Tout en sont de son droit d'amendement, le Parlement prend rarement l'initiative eu la motière, les textes votés étant la plu pont du temps d'origine gouvernementale.

Le Gouvernement, comme tout pouvoir, n'est cependant pas totalement autonome dans sa prise de décision. Celle-ci et le fruit d'axis autorisés comme de discussion ou de concertations avec d'autres autres. La réalité du processus de décisions et toutefois peu apponte parce qu'il relève de pratiques complexes dont aucune règle écrite me fixe de procédure.

Le processus de la décision fiscale et l'expression de la décision politique et s'organise aussi sur la base d'autres réseaux que ceux traditionnellement identifiés et analyses et dans laquelle s'affirme une approche technique qui n'est pas exempte toutefois d'influences politiques.

Ceux est une conséquence de l'évolution générale contemporaine et d'une structuration en réseaux au sein desquels la décision devient la productif d'une dialectique parfois difficile à appréhender.

C'est souvent l'attouchement de ce processeur que les parlementaires ont reculement ô la prise de décision fiscale, ou doit release le rôle important du Service de la législation fiscale aussi que celui d'organes de concentration et de conseil.

Les finances locales occupent aujourd'hui une place essentielle dans le processus de transformation de la société qui s'est engagé dans le cadre de la décentralisation des collectivités territoriales.

Aussi doit-on souligner d'entrée que les finances locales ne se situent pas seulement on cœur d'un processus de transformation des structures locales ; celui-ci concerne plus globalement les structures de l'Etat ainsi que celles du marché économique et financier.

Issue d'un double mouvement, un retrait de l'Etat et un élargissement corrélatif de l'espace d'intervention des initiatives locales publique et privées, une telle recomposition est celle qui résulte d'une connection plus étroite entre organismes du secteur multiples rapports qui se nouent en viennent à former de véritables systèmes, dépassons les cadres habituels de fonctionnement.

De fait, l'on peut constater qu'au plan local et depuis quelques années, les ponts se sont multipliés entre sphère publique et sphère privée ; des partenariats se sont instaurés, des relations se sont établies, qui forment aujourd'hui un ensemble aux ramifications particulièrement étendues.

D'autre part, une multitude d'acteurs interviennent dans un tel cadre, non seulement les communes, les départements, les régions et leurs établissements publics, l'Etat ainsi que les autorités déconcentrées de celui-ci, mais aussi des sociétés d'économie mixte, des associations, des groupements d'intérêt public, des entreprises, des banques, sans oublier les lieux avec les institutions financières.

Nous passerons en revue les déficits que doivent éviter les impôts locaux, ainsi que les qualités qu'ils doivent avoir. Nous constaterons ensuite que, en dépit d'un système cohérent de solutions, précisément dans les cas où les collectivités locales sont de taille réduite. Ceci est fort heureux, car nous savons que ce sont là les cas où l'éventail du choix entre tous les types d'impôts est le moins ouvert.

Les impôts locaux doivent satisfaire à un ensemble d'interdits plus rigoureux que les impôts d'Etat, en raison de la combinaison de deux nécessités évidentes : ne pas comporter de risque de doubles emplois, de la part de collectivités locales différents sur une même assiette ; ne pas nécessiter des contrôles aux limites des territoires des collectivités locales.

En ce qui concerne l'interdit des doubles emplois, il s'agit, certes, d'une exigence également applicable aux impôts d'Etat.

Mais les Etats exercent, eux, des contrôles à leurs frontières, et le respect de la règle de souveraineté fait que chaque Etat est absolument maître chez lui, dans le domaine des impôts indirects, sans courir la risque d'établir des impositions formant double emploi avec celles d'autres pays.

Ainsi, entre Etats, le risque de double emploi n'existe qu'en matière d'impôts sur le revenu et sur les patrimoines, de telle sorte que ces deux types d'impôts sont le principal objet des conventions de double impositions que les Etats concluent les uns avec les autres.

L'existence d'unités monétaires distinctes aide, du reste, au fonctionnement de ces conventions.

Il est évident hors de question que des contrôles aux frontières puissent exister entre les collectivités locales d'un même Etat.

Ce serait restreindre la liberté de mouvement des citoyens, et les apposer les uns des objectifs du pacte social. Ce serait aussi grever l'activité économique de charges inutiles et arbitraires.

Seule l'opiniâtreté de l'ancienne conception régaliennne de l'impôt, sans doute, a permis que les droits d'octroi perçus ou bénéfice des communes subsistent aussi longtemps que cela a été le cas.

Tout comme les impôts d'Etat, les impôts locaux doivent : être économiquement neutre (c'est-à-dire satisfaire ou postuler l'équité économique de la fiscalité) ; être équitables, c'est-à-dire taxer de la même manière des contribuables qui se trouvent dans des situations identiques, ou au sein de la collectivité locale.

L'Etat a, enfin, pratiqué, à tous les niveaux, une politique de déréglementation etc.

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# LA REFORME DU SYSTEME DE RETRAITES EN ROUMANIE

## - LE PILIER PUBLIC -

**drd. Dan Major**

*Dans le monde entier, les difficultés financières auxquelles se confrontent les systèmes de Sécurité Sociale sont engendrées principalement par le vieillissement de la population. Pour l'équilibre budgétaire, on adopte soit des mesures d'augmentation des contribution ou de diminution du quantum des prestations, soit leurs combinaisons. En Roumanie, la transition vers l'économie du marché, outre ses avantages économiques et sociaux indéniables, a impliqué aussi l'apparition des phénomènes négatifs, avec des implications sur le plan social, ce qui a déterminé un alignement permanent du système public de retraites sur les conditions économiques, sociales et politiques des 16 dernières années.*

### INTRODUCTION

Jusqu'en 2001, le système national de retraites en Roumanie était de type redistributif pay-as-you-go (PAYG), dans lequel les dépenses pour les retraites courantes étaient couvertes de la contribution des génération actives dont les retraites devaient être a leur tour financées par les générations futures. Dans le cadre du système public on acordait des pensions d'ancienneté, des pensions d'invalidité et de succession, de même que d'autres prestations sociales.

L'organisation et le fonctionnement du système public de retraites étaient règlementés par la loi 3/1977. Celle-ci spécifiait, entr autres, des prévoyances sur la pension supplémentaire, sur la retraite anticipée et sur des aspects concernant l'aide sociale. Les mutations majeures de la période de transition ont déterminé des

changements aussi du cadre législatif, la loi déjà évoquée étant successivement amendée après 1990.

Le droit à une pension se créait à l'accomplissement cumulatif des conditions concernait l'âge légal de retraite et l'ancienneté dans le travail. L'âge standard de retraite et l'ancienneté était de 57 ans pour les femmes et 62 ans pour les hommes. Mais en réalité, dans les conditions de la retraite anticipée à 52 ans les femmes et 57 ans les hommes, l'âge moyen de retraite avait atteint 51 ans pour les femmes et 56 pour les hommes<sup>1</sup>. L'unique critère d'éligibilité étaient constitué par l'ancienneté accomplie dans le travail, de 25 ans pour les femmes et 30 ans pour les hommes. Les personnes engagées et les chômeurs ont été les catégories socio-professionnelles qui ont bénéficié en particulier de ces prévoyances favorables à la retraite.

Il y avait aussi des fonds pour la pension supplémentaire auxquels contribuaient obligatoirement tous les salariés couverts par une assurance dans le système public. La période minimale de cotisation étaient de 5 ans, à la retraite l'assuré ayant la possibilité de bénéficier d'une augmentation du quantum de sa pension de 12% au maximum.

La base de calcul pour établir le quantum de la pension était représentée par la moyenne des revenus obtenus au cours de 5 ans consécutifs des 10 dernières années de travail, le revenu de référence étant constitué du salaire brut de base auquel on ajoute une série d'augmentations permanentes.

Le système public de retraites était entièrement financé des contributions payées intégralement des employeurs. Les salariés ne contribuaient qu'en pourcentage de 3% (initialement 2%) aux Fonds pour la pension supplémentaire. Les subventions du budget d'État ont constitué une source supplémentaire importante de revenus, dans le contexte des déficits successifs enregistrés du budget de la sécurité sociale d'État.

Le système de retraites était complété par de multiples systèmes de pensions constitués pour différentes professions. Ainsi, il y a eu des systèmes de sécurité

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<sup>1</sup> Lambrou, M.; Chirîtoiu, B. – „Le Système Roumain de la Sécurité Sociale et l'adhésion à l'Union Européenne”, Institutul European din România, Bucureşti, 2002, p.25

sociale des avocats, du personnel militaire et des structures MAI, des artistes, des écrivains et musiciens, des cultes religieux admis par la loi. La plupart de ces systèmes ont été intégrés dans le système de la sécurité sociale d'État, à partir de 1992, à présent seuls les avocats et les militaires ayant leurs propres systèmes de sécurité sociale.

### **1. Arguments pour la réforme**

Au début de la période de transition le système de retraites roumain se trouvait dans une situation relativement positive: le rapport entre les contribuables et les retraités était surunitaire et les taux de participation de la population sur le marché du travail enregistraient des valeurs élevées. Par conséquent, le budget de la sécurité sociale d'État était excédentaire, au moins dans les premières 5 années après 1989, et le taux de remplacement des revenus provenant des salaires avec la pension est resté à des niveaux élevés. L'action combinée de plusieurs facteurs tels le rapport de dépendance, les conditions difficiles du marché du travail (le chômage élevé) et la situation économique aussi, ont exercé un impact négatif sur les dépenses publiques pour les pensions et sur le soutènement du système.

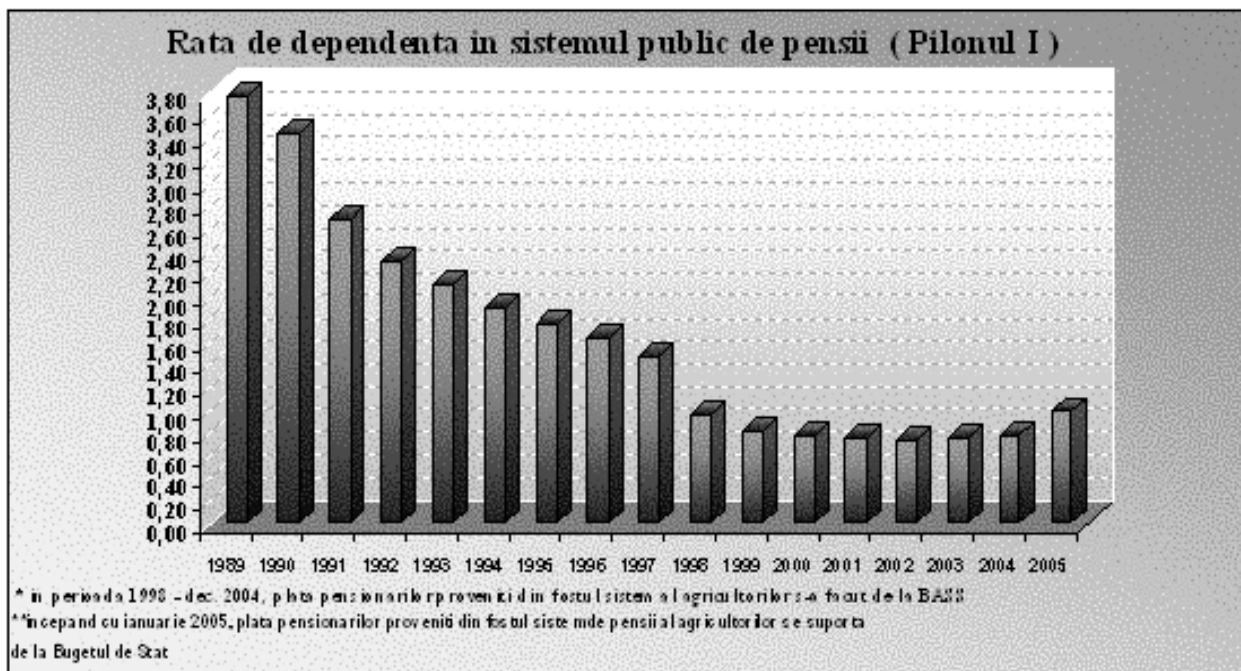
Le poids des dépenses publiques pour les pensions dans GPB se trouve étroitement en liaison avec la participation de la population sur le marché du travail. Une diminution du nombre absolu de contribuables n'est pas la seule explication qui vaille pour les niveaux bas des dépenses pour les pensions enregistrés en Roumanie. Ils sont dûs aussi aux petits revenus collectés au budget de la sécurité sociale d'État. Le dynamisme positif du secteur d'information, les dettes importantes au budget de la sécurité sociale d'État ont érodé le niveau des revenus disponibles, en dépit de certaines valeurs élevées de la participation de la population sur le marché du travail.

Les conditions démographiques de la Roumanie ne constituent pas le moteur de la réforme dans le domaine des retraites, mais, à long terme, elles ne peuvent pas être ignorées. Les données et les études des spécialistes indiquent une diminution de la population jeune sur le fond d'un taux de croissance naturelle négative, alors que le poids de la population de plus de 65 ans augmente. On estime qu'en 2020 le

pourcentage de la population âgé de plus de 65 ans dépassera 20% dans le total de la population active.

L'aggravation de cette situation s'explique par les changements radicaux produits dans le rapport entre les retraités et les contribuables. Pendant 10 ans (1990-2000), ce rapport a diminué de plus de moitié, de 3.43, en 1990, à 1.2 en 2000. Plus précisément, le nombre des retraités a doublé, tandis que, dans la même période, le nombre de contribuables s'est réduit de moitié. En 1990, environ 8.2 millions de salariés finançaient les pensions de 2.4 millions de retraités, en 2000 le rapport était presque unitaire, demeurant relativement constante jusqu'à présent (en février 2006 le taux est de 0.98), comme on peut le remarquer dans le graphique nr. 1.

**Graphique nr. 1 - Le taux de dépendance dans le système public de retraites – pilier 1**



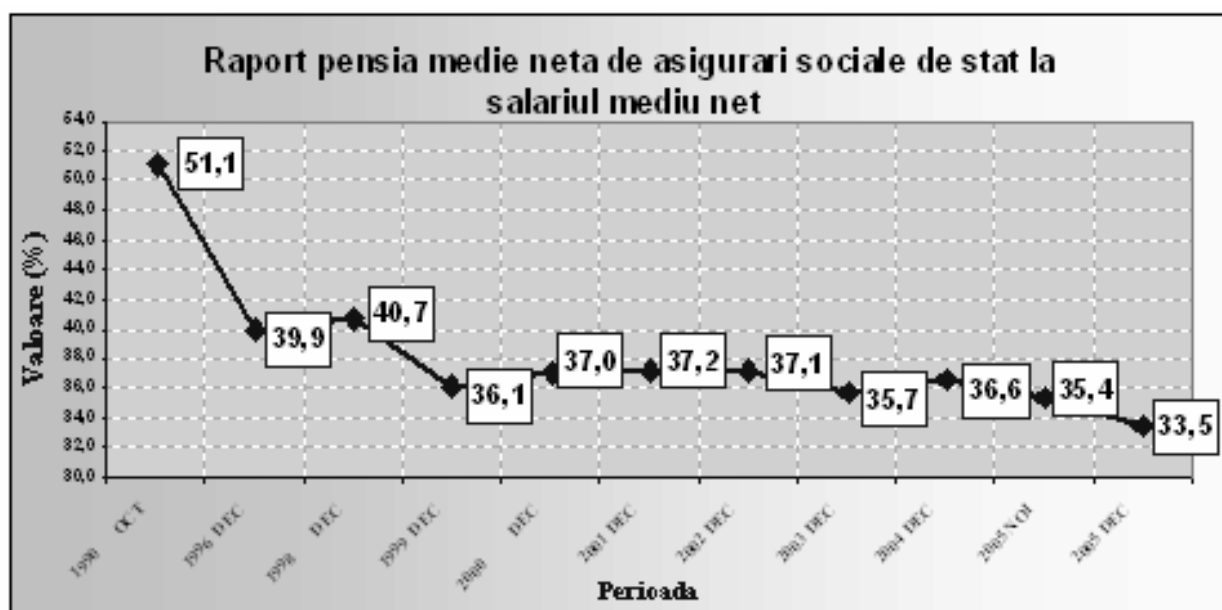
Sursa: CNPAS 2006

La croissance sans précédent du nombre des retraités est due, entre autres, aux conditions moins restrictives concernant la retraite anticipée et la retraite à cause d'une maladie (la pension d'invalidité). Cette tendance de croissance du nombre des retraités corrobore avec le phénomène du travail noir, de l'immigration accentuée de la force de travail jeune et les grandes dettes au budget de la sécurité sociale d'Etat complète le tableau des obstacles majeurs auxquels s'est confronté et se confronte encore le système public de retraites.



Dans le contexte de la crise financière que traverse le système public, les taux de remplacement des revenus obtenus des salaires avec la pension ont continuellement diminué, provoquant l'appauvrissement de la population de plus de 65 ans. Les mesures de recorréler des pensions appliquées dans cette période sont restées sans effet significatif, dans les conditions où l'indexation des pensions se rapportait à un taux inférieur au taux d'inflation. Cette pratique a continué après l'application de la loi 19/2000 aussi, la valeur réelle de la pension se diminuant toujours de sorte qu'à la fin de l'année 2005 on a enregistré le rapport le plus bas entre la pension moyenne nette et le salaire moyen net. L'inflation a érodé elle aussi la valeur réelle des revenus, la catégorie socio-professionnelle la plus affecté étant les retraités dont le pouvoir d'achat a diminué toujours, à voir le graphique suivant.

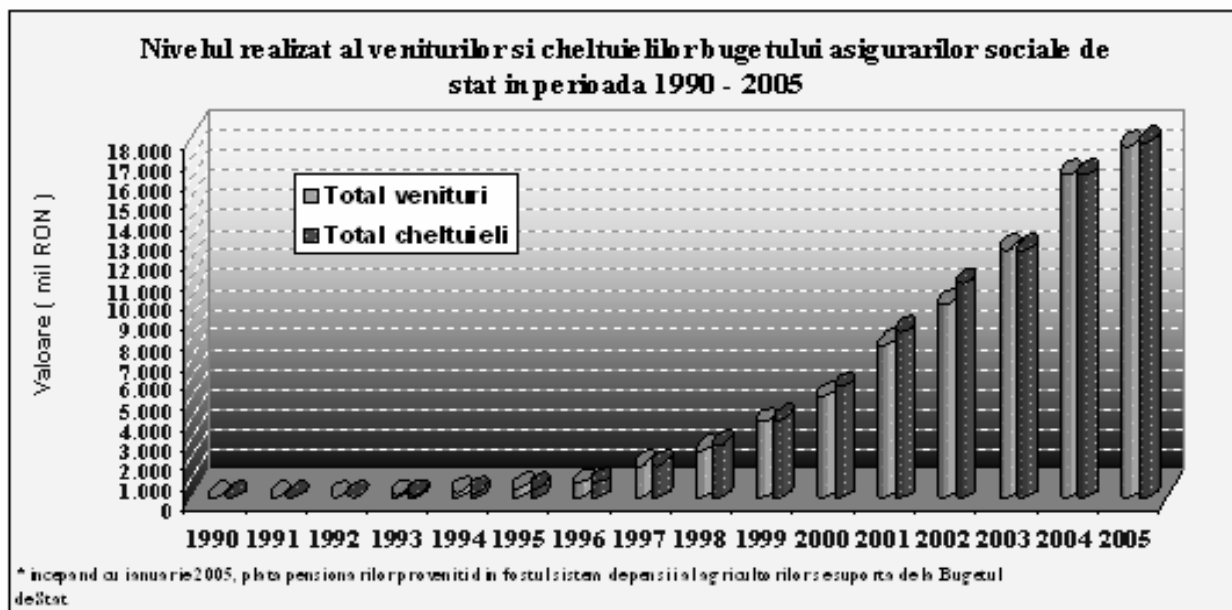
**Graphique nr. 2 – rapport de la pension moyenne nette de sécurité sociale d'Etat au salaire moyen net**



Source: CNPAS 2006

Les tendances présentées antérieurement ont eu leur impact sur la structure des frais publics aussi et ont affecté le soutènement financier du système. Le budget de la sécurité sociale d'Etat a enregistré des déficits successifs à partir de l'année 1995 et paraient à peine à être relativement équilibré en 2003, gardant depuis un équilibre relatif entre les revenus et les frais (à voir le graphique 3).

**Graphique nr. 3 – niveau réalisé des revenus et des frais du budget de la sécurité sociale d’Etat dans la période 1990-2005**



Sursa CNPAS

Dans la deuxième moitié de la décennie '90, les mesures prises pour la réforme du système de retraites ont visé, principalement, trois directions d'intervention: la viabilité financière du système de retraites, l'assurance des revenus adéquats aux retraités et la simplification de l'administration du système.

Premièrement, on a envisagé, d'une part, la croissance des revenus au budget de la sécurité sociale d'Etat, et d'autre part, la stabilisation des frais publics avec les pensions. Dans cette direction sont encadrées les mesures d'augmentation des contributions collectées à BASS qui pratiquement ont doublé au cours de la décennie '90 (de 15% en 1990 à 35% en 2000). La même tendance se fait remarquer aussi dans le cas des contributions pour la pension supplémentaire, de 3% en 1986 à 5% de 1999 jusqu'en avril 2001 quand elle a été annulée.

La prolifération sans précédent des emplois dans des groupes spéciaux de travail, à des conséquences importantes sur la croissance du nombre des retraités, a motivé l'introduction de la contribution différenciée par groupe de travail (loi 49/1992). Si en 1992 la contribution se situait dans un intervalle entre 25-35%, en 2000 sa valeur était contenue entre 30-40%.

On remarque aussi une amélioration du degré de couverture dans le système public: à partir de 1995, on offre aux personnes qui déploient des activités indépendantes et à celles engagées conformément aux conventions civiles de travail, la possibilité de conclure des contrats de sécurité sociale, bénéficiant des mêmes droits que les personnes assurées obligatoirement dans le système public. Finalement, certaines prestations sociales financées du budget de la sécurité sociale d'Etat sont transférées à d'autres institutions.

Deuxièmement, on a adopté des mesures qui visaient la conservation de la valeur réelle des pensions. Le mécanisme d'indexation des pensions par rapport à l'inflation a constitué la méthode préférée utilisée par les facteurs de décision. En réalité, l'indexation s'est réalisée à un pourcentage moindre que l'inflation, ce qui s'est reflété aussi dans la décroissance du rapport entre la pension moyenne des assurances sociales et le salaires moyen de l'économie de 50% (le graphique nr. 2).

Le mécanisme d'ajustement compensait aussi, d'autre part, les inégalités engendrées par la manière de calculer les pensions et leurs indexations partielles. La base de calcul pour le quantum des pensions ne se trouvait que partiellement en corrélation avec le taux de l'inflation, ayant pour effet des différences pour les générations des retraités. Trimestriellement, pour assurer un niveau adéquat des revenus aux retraités et diminuer les inégalités grandissantes entre les générations, le gouvernement faisait indexer les pensions. Mais ces mesures de recorrélation étaient limitées par la disponibilité de ressources financières.

Troisièmement, toute une série d'actes normatifs ont visé la simplification de l'administration proprement-dite du système public des pensions: de 1993 à 1998 différents schémas occupationnels ont été intégrés dans le système général, de sorte qu'à présent seuls les avocats et les cadres militaires bénéficient encore d'un régime propre de sécurité sociale.

## **2. La restructuration du pilier public – le premier pas de la réforme**

La fluctuation continue des pensions de la période 1995-2001 constitue la preuve des indexations ad-hoc des bénéficiaires. Elle est fréquente après l'inflation et est suivie de projets de recalculer les bénéficiaires. Depuis 1996 on a conçu cinq projets

de recorrélation pour le système de retraites d'Etat et deux pour le système de retraites pour les agriculteurs. Les règles d'indexation et de recorrélation n'ont pas été uniformes pour tous les groupes de bénéficiaires de pensions pour vieillesse, invalidité, succession, ni même pour le cadre de chaque groupe.

L'adoption de la loi 19/2000 concernant le système public de retraites et autres droits de sécurité sociale a marqué le commencement de la réforme du système de retraites roumain. On envisageait aussi bien la révision du système PAYG, que l'introduction des sources alternatives de financement. Le modèle promu des autorités roumaines a été inspiré par „le modèle des trois piliers” soutenu par la Banque Mondiale et d'autres institutions financières internationales.

La Roumanie a initié une stratégie de réforme qui est basé sur un cadre qui sollicite la diversification des sources de financement du système de retraites. Ainsi, la première composante de ce nouveau système repose sur la rationalisation et l'amélioration de l'ancien schéma de type PAYG, celui qui a été légiféré par la loi 19/2000 et compléter ultérieurement. La deuxième composante, au caractère obligatoire, sera financée et administrée par le secteur privé. Enfin, la troisième composante fait référence aux schémas bénévoles de retraites, administrés exclusivement par la secteur privé.

Les plus importants éléments de nouveauté introduits par cette législation pour la restructuration du pilier public concernent:

a) la restriction de l'accès aux bénéfices par:

- l'augmentation graduelle, jusqu'en 2014, de l'âge de la retraite de 57 ans à 62 ans pour les femmes et de 62 ans à 65 ans pour les hommes. Cet aspect a retardé la croissance du nombre des bénéficiaires du système et son utilisation comme alternative pour la main d'oeuvre redondante;

- la sollicitation d'un nombre plus grand d'années de travail pour l'octroi de la retraite (l'ancienneté dans le travail augmente de 30 ans à 35 ans pour les hommes et de 25 ans à 30 ans pour les femmes);

- l'introduction d'un filtre plus sévère de contrôle en ce qui concerne l'octroi des pensions d'invalidité. Cette prevoyance a contribué à la réduction du nombre de

retraités et implication de la différence entre le nombre des contribuables et celui de bénéficiaires;

b) l'introduction d'une nouvelle méthodologie de calcul de la pension (un système de points d'inspiration allemande). La nouvelle méthodologie compte les contributions payées chaque année de travail, de sorte que le quantum de la pension se situe dans l'intervalle 30-50% des revenus bruts réalisés. Pour contrebalancer l'inflation et la dévalorisation, les pensions seront indexées trimestriellement<

c) l'extension du groupe des bénéficiaires et une plus précise définition de la sphère de couverture des bénéfices. Ainsi, le système public:

- englobe, à côté des employés et des libres-professionnels, des engagés avec des conventions civiles et les chômeurs. De cette façon on réalise une couverture universelle;

- introduit des conditions restrictives pour l'encadrement des emplois dans la catégorie des emplois dans des conditions particulières, réalisant une réduction du nombre des personnes encadrées dans ces emplois;

d) redéfinition du régime des contributions pour les pensions dans le système public, celles-ci étant supportées en pourcentage de 9.5% du salaire des engagés et la différences par les employeurs. Cette mesure transmet un message politique et économique important. Le signal de la classe politique vise la responsabilisation: l'Etat est responsable de l'établissement du cadre général de la protection sociale, mais l'individu, par son salaire et ses contributions est, substantiellement responsable pour lui même. Du point de vue de la contribution d'un engagé, toute croissance des bénéfices conduit instantanément à l'augmentation des contributions prélevées des salaires individuels. Le message économique qui en résulte est que le salarié est celui qui paie, au moins partiellement, pour la sécurité sociale;

e) l'administration du système public de retraites se réalise par une institution autonome avec des compétences dans la collecte et la distribution des fonds publics de pensions, respectivement la Maison Nationale de Retraites et autres Droits de la Sécurité Sociale.

En conclusion, la restructuration inévitable du marché du travail a engendré au cours de la transition à l'économie de marché une série de pressions sur le système de retraites, au fur et à mesure que la participation de la main d'oeuvre a diminué et le chômage s'est accru. Les mesures de politique économique orientées à court terme, la retraite à l'avance, les critères permissifs d'établissement de la pension d'invalidité, la croissance du taux d'impos, aussi bien que les changements ad-hoc des bénéficiaires n'ont fait qu'aggraver les problèmes du système.

Dans ce contexte, la dernière loi des pensions offre le cadre institutionnel pour la réduction des coûts et évincer les motivations adverses. Cependant, restent encore présents les problèmes liés exclusivement au taux de l'imposable en soi, qui pourrait rendre de nouveau le système inefficace.

Un pas important dans le progrès de la réforme a été constitué par la finalisation du processus de recalculer les pensions à la base de la nouvelle méthode de pointage. Nous apprécions qu'elle représente un acte d'équité sociale, les contribuables bénéficiant ainsi de pensions conformes à la valeur des contributions payées durant leur vie active. Une remarque à faire, c'est que les pensions qui avaient une valeur surdimensionnelle par l'application des anciennes méthodes de calcul sont restées à leur valeur initiale, de sorte que les avantages par les valeurs respectives plus importantes peuvent continuer à en jouir. Cet aspect peut être corrigé, à l'avenir, par éviter d'englober cette catégorie de pensions dans les futurs processus d'indexation.

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# **THE NEED OF IMPLEMENTATION IFRS ON ROMANIAN CAPITAL MARKET**

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*The IFRS implementation and application efforts are of a great importance for the Romanian capital market development, since institutional and individual investors are “seeking” for a universal “accounting language” that allows a comprehensive view upon financial position, performances and changes in financial position of securities issuers that are listed on the stock exchange.*

*The decision of undertaking a certain level of risk when investing in securities is highly correlated with the need of understanding certain financial features related to the companies that issue financial instruments for the purpose of raising public funds. In this topic, one of the major contributions that IFRS have come with, is the require that financial statements are prepared in accordance with a set of qualitative attributes and they need to offer a true and fair view of the financial position and performances of the securities issuers.*

*From this perspective, the risk of default and the risk of bankruptcy are significantly reduced, provided that investors become more confident of the capital market mechanisms and its reason to exist in a market economy based system.*

## **1. The IFRS „revolution”- a general approach**

It is a nowadays reality that providers of debt or equity capital, generally defined as investors, operate on a truly global basis. They have a real opportunity to invest without barriers and in a profitable manner their financial resources and, as a result, they increasingly expect that financial information on which investment decisions are based, to be presented in a comprehensive, transparent and commonly understood format.

By using a single universal “accounting language”, such as reporting in compliance with International Financial Reporting Standards (IFRS), companies’ financial statements try to put an end to the various problems of interpretation associated with reporting on different accounting treatments, specific to each national accounting system.

The complex process of developing and implementing a set of International Financial Reporting Standards has become a global business project, that mainly aims to encourage the free flow of funds between international capital markets by making comparable the financial statements of multinationals, so that investors and other users can assess their financial position and performance.

This process has been in a constant progress since the early seventies, under the leadership of the International Accounting Standards Board (IASB) and its predecessor, the International Accounting Standards Committee (IASC).

In June 2000, the European Commission has made a major step on the “roadmap” of achieving international accounting convergence, by publishing



a communication<sup>1</sup> which proposed that all listed companies prepare their financial statements in accordance with one single set of accounting standards, namely International Financial Reporting Standards (IFRS), at the latest by 2005.

Perhaps the biggest barrier met by the efforts sustained to elaborate a truly global and harmonized set of international financial and accounting reporting standards is the need to converge IFRS with US GAAP and there are encouraging signs that this will happen. For instance, at a recent United States-European Union summit meeting in Washington, there were announced a series of undertakings designed to implement the Declaration on Enhancing Transatlantic Economic Integration and Growth. One of the undertakings is "promoting convergence of accounting standards as soon as possible".<sup>2</sup> In addition, The International Organization of Securities Commissions (IOSCO) has recommended that the world's regulators permit foreign issuers to use IFRS in preparing financial statements for cross-border offerings and listings.

Whilst the implementation process of IFRS has been reasonably successful around the world, the initiative has not been entirely free of controversy and challenges, even though the most significant of all are not around the principles of the standards themselves, but more with their practical implementation, highly influenced by different accounting national cultures.

The recent evolutions have defined a period of transition during which companies, especially public held ones, have sought to reconsider their

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<sup>1</sup> Communication from the Commission to the Council and the European Parliament- "*EU Financial Reporting Strategy: the way forward*", Brussels, 2000, page no. 6

<sup>2</sup> *The United States and the European Union initiative to enhance Transatlantic Economic Integration and Growth*, 2004 Dromoland Summit

accounting policies and to assess the impact of IFRS on their management and published financial statements. Given the high level of uncertainty surrounding the application of IFRS, many entities have managed the transition to IFRS temporarily, despite the fact that this kind of approach does not provide the sound basis for an auditable and permanent solution.

Looking ahead, the IASB has a full agenda of projects to introduce new standards and review the workings of existing standards. So, coping with changing standards and transitional arrangements is going to be a permanent feature of the reporting landscape for the foreseeable future. As the main body of standards settles down, the challenge of IFRS has moved from one of accounting principles to one of presentation and disclosure.

Although implementing IFRS is radical in some areas, it does not give rise to fundamental changes concerning the pattern in which accounting transactions are recorded, processed and reported. After all, at this point in time there are probably more similarities between IFRS and national accounting principles around the world than there are differences. Therefore, in practical terms, the challenge of implementing IFRS is around coping with managing the transition to a new reporting framework whilst simultaneously providing comparatives, according to an old standards regime and being able to report and understand the differences. In systems terms, coping with IFRS is all about flexibility, both now and in the future.

## **2. Concerning some challenges and the importance of adopting IFRS**

Recently studies reveal the fact that almost all countries in the European region, but not only, are experiencing an intensive process of implementing IFRS, even though there are notable differences regarding the

categories of companies covered, the certain technical and methodological solutions to how the standards are phased in and actually enforced.

Inevitable, the process of adopting IFRS is confronted with some inherent and provoking *challenges*<sup>3</sup> due to:

- fundamental differences between national and international attitudes and practices that arise from diverse historical, cultural and legal traditions.
- the “substance over form” concept, which seems to be at the heart of the IFRS implementation problem. IFRS are written in a conceptual way and that is the very reason they can be characterized as a “substance over form” approach to accounting.

For example, IFRS do not refer to debits and credits, there are no instructions on bookkeeping, there are no account numbers, no instructions on what transaction documents should look like or any instructions on how the losses from the guilty party in the event of finding an inventory difference should be recovered. From this perspective, accounting regulation organisms have traditionally been very prescriptive and thus invite a “form over substance approach”. Indeed, accountants may be meticulous in ensuring that documents and the registered financial transactions have the correct form, even though it may, however, inaccurately reflect the substance. Where accountants have little or no experience with the substance over form concept, they may not be prepared at first to apply it.

- a company’s financial reporting needs to evolve, in order to meet new market demands.

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<sup>3</sup> Implementing IFRS in Russia- 25 recommendations to facilitate the transition to IFRS , issued by the Russian Corporate Governance Roundtable

Before the 1990's, under the socialist regime, accountants were sensed as highly trained individuals, fully competent to provide the information needed by the state for national statistics and control. That type of information was never intended to be used by the financial markets, for corporate governance purposes or for the protection of investors.

In the new market economy system, the users of information and their needs are quite different, and company financial reporting must evolve to meet the needs of changing users and their informational demands. This is an opportune time to make this change alongside the European Union member states, including aspirants, as they move to introduce IFRS in consolidated accounts of listed companies.

In addition to the above mentioned challenges, some questions<sup>4</sup> may arise and require competent answers, in order to address a successful subscribing to a IFRS reporting basis:

- what are the significant impact areas for each business and how complex will it be to convert to IFRS?
- how will IFRS impact reported business performance and how will this impact be communicated effectively internally and to the market at large?
- what expertise and resources will be needed to ensure a successful conversion?
- what are the potential benefits of converting to IFRS?

As for publicly interest entities, especially listed companies, the process of converting financial reports on IFRS basis is being associated with some considerable *advantages* that will out-weight the short term costs, such are:

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<sup>4</sup> KPMG- *Challenges and opportunities for Australian organizations*, [www.kpmg.com.au](http://www.kpmg.com.au)

√ reporting in compliance with IFRS will facilitate *better comparability* of companies' financial performances and may also result in *greater transparency* about companies' activities to outsiders;

√ concerning that providers of risk capital constitute the most important category of users, in the light of information disclosed by financial statements, the process of developing and implementing IFRS provides both *a stimulus and an opportunity for companies to improve their level of communications with all stakeholders*. The enhanced relations resulting from this improvement can provide a competitive advantage, particularly in terms of widening a company's access to capital markets and therefore, lowering its cost.

√ the increasingly qualitative requirements for the financial information prepared by listed companies, combined with both stricter enforcement of and better compliance with standards' disclosure requirements is designed to assure a *better protection* and an *adequate transparency level* for their investors, in accordance to general principles that define the corporate governance framework.

√ provided that reporting on a IFRS basis is mainly orientated to produce more accurate and reliable information, so that shareholders and potential investors are able to take well-considered economic decisions, IFRS should also bring *lower costs* and *wider availability of capital* through increased cross-border listings and investment opportunities

### **3. The level of IFRS implementation process on the Romanian capital market: present day and a prospective view**

Among the requirements of the national accounting system harmonization program, one referred to implementing and application of

IFRS by the entities operating on the capital market, beginning with 2005 reporting year.<sup>5</sup>

Despite the fact that reporting in compliance with International Accounting Standards and European Directives, covered a period of three years<sup>6</sup>, the beginning of 2005 reporting year has brought a radical change by dropping out the necessity of adopting IFRS.<sup>7</sup> One possible explanation for this reconsidering point of view may be related to the needs of fulfilling some requirements specific to the European integration process.

From this perspective, the link to the IFRS reporting has not been entirely “cut off”, as the entities operating on the capital market (listed companies, investment companies, intermediaries, investment funds, etc.) still have the option to prepare a distinctive set of financial statements, in the spirit of IFRS, for their own needs or other users’ needs of financial information, except for the governmental agencies and fiscal authorities, provided that adequate capacity of implementation is assured.<sup>8</sup>

Concerning the requirements of European Union accession process and the valuation reports issued by involved institutions’ (national and international accounting and audit regulators, external supervising organisms, rating agencies, etc.), the National Securities Commission will establish adequate implementation rules regarding reporting in the spirit of IFRS, beginning with 2007.

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<sup>5</sup> Minister of Public Finance’s order no. 1827/2003, regarding changing and completing some accounting settlements, 6<sup>th</sup> article.

<sup>6</sup> Ministry of Public Finance and National Securities Commission President’s order no. 1742/106/2002 regarding the approval of accounting settlements harmonized with the 4<sup>th</sup> European Union Directive and International Accounting Standards, applied to entities supervised by National Securities Commission.

<sup>7</sup> National Securities Commission President’s order no. 75/2005 regarding accounting settlements in accordance with the 4<sup>th</sup> European Directive, applied to entities authorized, settled and supervised by National Securities Commission.

<sup>8</sup> Minister of Public Finance’s order no. 907/2005, regarding the categories of entities that apply to IFRS and European Directives.

## 4. Conclusions

Without doubt, efforts sustained for implementing financial reporting under IFRS, especially for listed companies, will result in some major benefits for the capital providers, according to basic principles for a corporate governance framework- transparency, shareholders' protection and a higher level of information accuracy.

Despite the fact that present national accounting settlements are accorded to European Directives, publicly companies (including those who are listed) are encouraged to prepare a distinctive set of financial statements using "IFRS language", in order to meet the requirements of international accounting convergence process.

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# Fixed Assets Accounting of the Public Institutions Issues

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*The Romania Public institutions Accounting is undergoing a reform process focused on aligning the Romanian methodology to the European context. For this reason a new accounting plan has been issued based on the French public institutions account plan. Fixed assets accounting rules are significantly changed since the last account plan. This paper is a brief analyze of the new accounting system of the fixed assets*

## **1. The fixed assets as defined by the new accounting**

The new accounting system of the public institutions is based on the French Public accounting system, and has many similarities with the one used by the companies. The instructions define fixed assets as “*assets intended for a long term use*”. They include non-corporal, corporal and financial assets.

- *The non-corporal fixed assets* are defined as assets without a physical substance.
- *The corporal fixed assets* are defined as objects or system of objects which have a greater value than the limit established by government and a use period longer then a year.
- *The financial fixed assets* are deposits, capital investments, and contractual rights. Even if is not specifically expressed, they should be over a year term.

At this point we can say that fixed assets owned by public institutions are very similar to the fixed assets owned by any other type of entity. However, the property of

the government is defined by other rules than any other. The fixed assets are separated into two main categories with different laws governing the property attributes.

- Fixed assets belonging to the *private property* of the central and local government
- Fixed assets belonging to the *public property* of the central and local government

If the private property of the state is supposed to be identical with any other property, the public property has three main attributes, which differentiate-it from any other property:

- The propriety rights cannot be conceded. That means that the fixed assets belonging to the public propriety cannot be either sold or donated, but only leased.
- They cannot be subject to warranty or expropriated by court decision
- The propriety right cannot be obtained by any means by private entities, including long term use or good faith possession.

## **2. Differences and similarities between the fixed assets accounting of the public institutions and the fixed assets accounting of the companies**

From the point of view of definitions, the new law instructions contain no significant changes in these aspects compared to the former regulations. The only addition which can be observed is the introduction of the immaterial or non-corporal fixed assets as a distinct category in the public institution accounting. However this was a very necessary step considering that companies are using this category for a long time now.

What is really different between companies and public institutions is that institutions do not always depreciate their fixed assets. The introduction of the fixed assets funds in the public institutions account plan, and the usage rules suggest that there should be a certain proportion of fixed assets which are not subject to depreciation.

Companies have only one fixed assets category, the land, which cannot be subject to depreciation. Public institutions appear to have this kind of assets at all categories.

From the point of view of public property assets, this can make sense. Fixed assets entering public property are not allowed to be sold. Because of that, the expenses regarding them are supposed to be recorded at the acquisition moment. In this case depreciation expenses cannot be recorded, because that would mean double expenses for the same goods. However, in fact public property can be protected by law against anything but depreciation, because with the exception of land, all fixed assets are affected by it, either recognized by the law or not.

The Funds accounts, which are connected to the non-depreciable fixed assets, are a traditional approach of the Romanian old accounting, which used to be cash based accounting. In fact they have been used by companies also in the past, but they make really no sense at all in an accrual principle based accounting plan.

The Fixed assets – Fixed assets fund relationship, which has been a traditional approach in the Romanian fixed assets accounting appears to be the main reason for introducing the notion of “non depreciable assets”. This has been a unsuccessful approach in the first companies account plans after the introduction of the accrual accounting, and it is to be expected to have the same faith in the public institutions accounting.

At a practical level the acquisition of fixed assets could be treated as follows:

*A. If the fixed assets are depreciable:*

Fixed assets account (2XXX) = Suppliers of fixed assets account (404X)

*B. If the fixed assets are not depreciable:*

Fixed assets acquisition expenses acc. (682x)= Suppliers of fixed assets acc. (404)

And: Fixed assets account (2XXX) = Funds account (10X)

This is very important if we regard this two accounting approaches from the financial results point of view. Using the “A” system implies having as expenses in this year final report only the depreciation expenses of this year, that means maximum one third of the total value of fixed assets acquisitions, using the “B” system implies having as expenses the whole value of the purchased assets at the end of the year. Due to the fact that the value of the fixed assets is usually very significant, the results can be significantly affected, so this issue is to be approached with caution.

Due to the fact that this regulation is new and untested at the practical level, changes are to be expected. If we consider the past approaches regarding the companies accounting, the funds use is due to disappear, at least in what concerns the private property of the state. So it is to be expected that public accounting will use the same system of accounts in the same manner as companies for the private property issues.

In what concerns the public property of the government, “the funds – fixed assets accounting”, as seen in the “B” article, approach, is a very good solution, very well tested in the past, so it should remain as long as the laws regarding the public property remain the same.

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