

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC) Romania

ACCOUNTING AND AUDITING

December 31, 2008

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Executive Summary

This report provides an updated assessment of corporate financial reporting requirements and practices within the enterprise and financial sectors in Romania. The first Accounting and Auditing Report on the Observance of Standards and Codes was published in 2003. This report uses International Financial Reporting Standards, International Standards on Auditing, and the relevant portions of European Union law (also known as the *acquis communautaire*) as benchmarks. This report describes the situation as at June 30, 2008, but also refers to developments subsequent to that date.

Romania has been successful in implementing several recommendations from the 2003 Accounting and Auditing Report on the Observance of Standards and Codes: Romania has revised its accounting and auditing law and regulations; one major university has implemented a better accounting curriculum; and the Chamber of Financial Auditors of Romania has (i) enhanced its independence *vis-à-vis* the Government, (ii) translated International Standards on Auditing, (iii) initiated a quality control mechanism, and (iv) organized continuing professional education for auditors including training in International Financial Reporting Standards. However, the practical implementation of an oversight body of the external audit function remains outstanding, and enforcement mechanisms over general purpose financial statements remain weak. The new status of Romania as a European Union Member State and its fast growing economy bring new challenges to the country, including achieving high quality implementation of the *acquis communautaire* as it relates to corporate financial reporting.

Background. Romania is a middle income country with a gross domestic product of US\$ 165.9 billion in 2007, the largest in South Eastern Europe, with important contributions from construction, services, industry and agriculture. The contribution of the private sector to gross domestic product exceeds 75%. With a population over 21 million, Romania is the seventh largest among the 27 current members of the European Union. Romania is steadily converging in income, competitiveness and living standards towards the average across the European Union, but the gap remains large with an income per capita of around 40% of the European Union average. Romania joined the European Union on January 1, 2007 and the integration of Romania into the single market has made the country attractive for foreign direct investment. The robust economic growth enjoyed in the recent years has triggered large and increasing shortages of labor and skills.

Regulatory and Institutional Framework. Romania has succeeded in transposing the *acquis communautaire* into its accounting laws and regulations; a new Audit Law on statutory audit introduces the new requirements of the amended Eighth Company Law Directive.¹ Some aspects of this law are already included in the financial reporting framework, such as professional education and licensing requirements, the public registry and the quality assurance system, but further strengthening will be needed for them to fully comply with the high quality requirements of the amended Eighth Company Law Directive. The Public Oversight System described in the new Audit Law is comprehensive but its practical implementation will be challenging.

Accounting rules are aligned with the Fourth and Seventh Company Law Directives, as well as with the Transparency Directive, the IAS Regulation (EU Regulation 1606/2002), and the Bank and Insurance Accounts Directives. Since 2007, listed companies have been required to use International Financial Reporting Standards *as endorsed* by the EU to prepare their consolidated financial statements. Financial statements are available at the trade registry, albeit not electronically.

However, Romanian Accounting Standards for the enterprise sector should be made comprehensive and complemented by authoritative guidance. Although Romania has implemented the relevant accounting directives, the absence of many elements of the necessary supporting infrastructure, combined with Romania's rule-based accounting traditions, present challenges in ensuring that the principles contained in European Union legislation are applied in a manner that leads to high quality financial reporting.

Romania could now shift from a process for establishing Romanian accounting standards that involves preparation and adoption by regulators and supervisors and approval by the Ministry of Economy and Finance to a more inclusive standard setting system. The system for setting standards for non public interest entities would benefit from active involvement of preparers and users of financial statements and the accounting profession in addition to regulators and supervisors. The member firms of international audit networks should be encouraged to participate in the process as they have the means and the international experience to help.

The governance principles of both the Chamber of Financial Auditors of Romania and the Body of Expert Accountants and Authorized Accountants of Romania are not always clear. The governance arrangements of both bodies should be reviewed and the results of the review published. Such a review should include an examination of related party transactions, the leadership nomination process, and the duration and concentration of power and authority.

The Chamber of Financial Auditors of Romania and the Body of Expert Accountants and Authorized Accountants of Romania have similar adequate education requirements. However, the quality of both the examinations and the courses leading to those examinations need to be

¹ On November 7, 2008, Parliament enacted the law 278/7, the amended Audit Law, approving the Emergency Government Ordinance 90/2008 on statutory audit, dated June 24, 2008, and published on June 30, 2008 in Romania's Official Gazette, Part I, 481/2008.

monitored closely. In addition, there is a need to align the post-qualification professional education requirements of both bodies to facilitate access of future members of the Chamber of Financial Auditors of Romania to the Body of Expert Accountants and Authorized Accountants of Romania and *vice-versa*.

There is a lack of qualified accountants in Romania. The accounting and auditing curricula of the Academy of Economic Studies of Bucharest have been enhanced but more initiatives are necessary.

The Chamber of Financial Auditors of Romania regulates the external and internal audit professions. When the Chamber of Financial Auditors of Romania was established in 1999, a requirement for an internal auditor was established for companies for which financial statements would be subject to audit. Both external and internal auditors are members of the Chamber of Financial Auditors of Romania. A Romanian chapter of the Institute of Internal Auditors is now a full member of the international body. While at the inception of the internal audit profession the supervision of the Chamber of Financial Auditors of Romania may have been warranted, other arrangements should now be considered.

Corporate Sector Financial Reporting and Auditing in Practice. Many stakeholders perceive that the quality of corporate financial reporting has steadily improved since 2003. Two main factors may be cited: Romania has transposed the *acquis communautaire* into its legal framework; and major Romanian companies have been acquired by international investors that have rapidly enhanced the financial reporting practices of acquired entities, aligning these with their own needs. However, in preparing general purpose financial statements, preparers are still influenced by tax reporting issues. Investors and banks have a preference for financial statements prepared under International Financial Reporting Standards when making investment or loan decisions and rely on audit reports issued by member firms of international audit networks. Reviews of financial statements and audit reports are seen as a complement to the due diligence process when examining loan applications.

The newly adopted Audit Law requires audits to be carried out using International Standards on Auditing as translated into Romanian. The Chamber of Financial Auditors of Romania translates International Standards on Auditing at the time these are published by the International Auditing and Assurance Standards Board. The latest version of International Standards on Auditing in force was issued in 2006. Since 2006, all International Standards on Auditing issued by the International Auditing and Assurance Standards Board have been part of a project for clarifying International Standards on Auditing (the clarity project) and will be applicable in 2009.

Although some progress has been made since 2003 when the enforcement mechanisms were almost non-existent (except for the banking system for regulatory purposes), the quality assurance system and enforcement mechanisms for general purpose financial statements and audit requirements remain weak.

The quality assurance system of the Chamber of Financial Auditors of Romania is operational but the monitoring team, which includes five professional auditors, lacks professional auditing experience and skills, particularly in relation to the financial sector. The Chamber of Financial Auditors of Romania will need to strengthen significantly its monitoring team and the quality assurance system if it is to be effective in meeting the goals of the amended Eighth Company Law Directive.

The enforcement mechanisms for general purpose financial statements appear not to be functioning for all supervisors. While the National Bank of Romania monitors and enforces financial reporting requirements applicable to banks and non-bank financial institutions, no instances of enforcement of financial reporting requirements by the insurance supervisor were published recently. This calls into questions the effectiveness of the Insurance Supervisory

Commission's monitoring of the quality of general purpose financial statements issued by insurance undertakings. However, on the prudential side, the Insurance Supervisory Commission has built *inter alia* an early warning system to monitor the soundness of the insurance sector and also monitors several reports on technical reserves and other sectoral data. The monitoring unit responsible for listed companies at the National Securities Commission started its activities in late May 2008 and will face the challenge of reviewing consolidated financial statements prepared under International Financial Reporting Standards.

Main Recommendations

1. The recently-adopted Audit Law should be implemented rapidly, including designing policies and procedures of the new Council for the Public Oversight of the Statutory Audit Activity.
2. The accounting law should require all public-interest entities, as defined by the law, including listed companies without subsidiaries and private pension funds, to prepare individual financial statements in accordance with *endorsed* IFRS.
3. The Chamber of Financial Auditors of Romania and the Body of Expert Accountants and Authorized Accountants of Romania should undertake a review of their governance principles and practices and the roles and responsibilities of both professional bodies should be publicly clarified,
4. The Chamber of Financial Auditors of Romania, the Body of Expert Accountants and Authorized Accountants of Romania, and universities should coordinate their efforts to improve the quality of professional education and agree on a strategy for converging the two professional education systems.
5. The Chamber of Financial Auditors of Romania should strengthen the capacity of its monitoring unit to ensure it is effective in meeting the goals of the amended Eighth Company Law Directive.
6. The Chamber of Financial Auditors of Romania should not regulate the internal audit profession.
7. The Insurance Supervisory Commission and the National Securities Commission should ensure effective supervision of the general purpose financial statements of insurance undertakings and listed companies respectively, and publish in their annual reports information about their supervisory processes and the results of these processes.

Next Steps. Implementation of policy recommendations made in this report will require the government to play an active role in cooperation with other key stakeholders, including supervisors, the accounting and auditing profession, and universities, gathered in the Council of Accounting and Financial Reporting. The Council of Accounting and Financial Reporting should advise the government on the implementation of the recommendations.

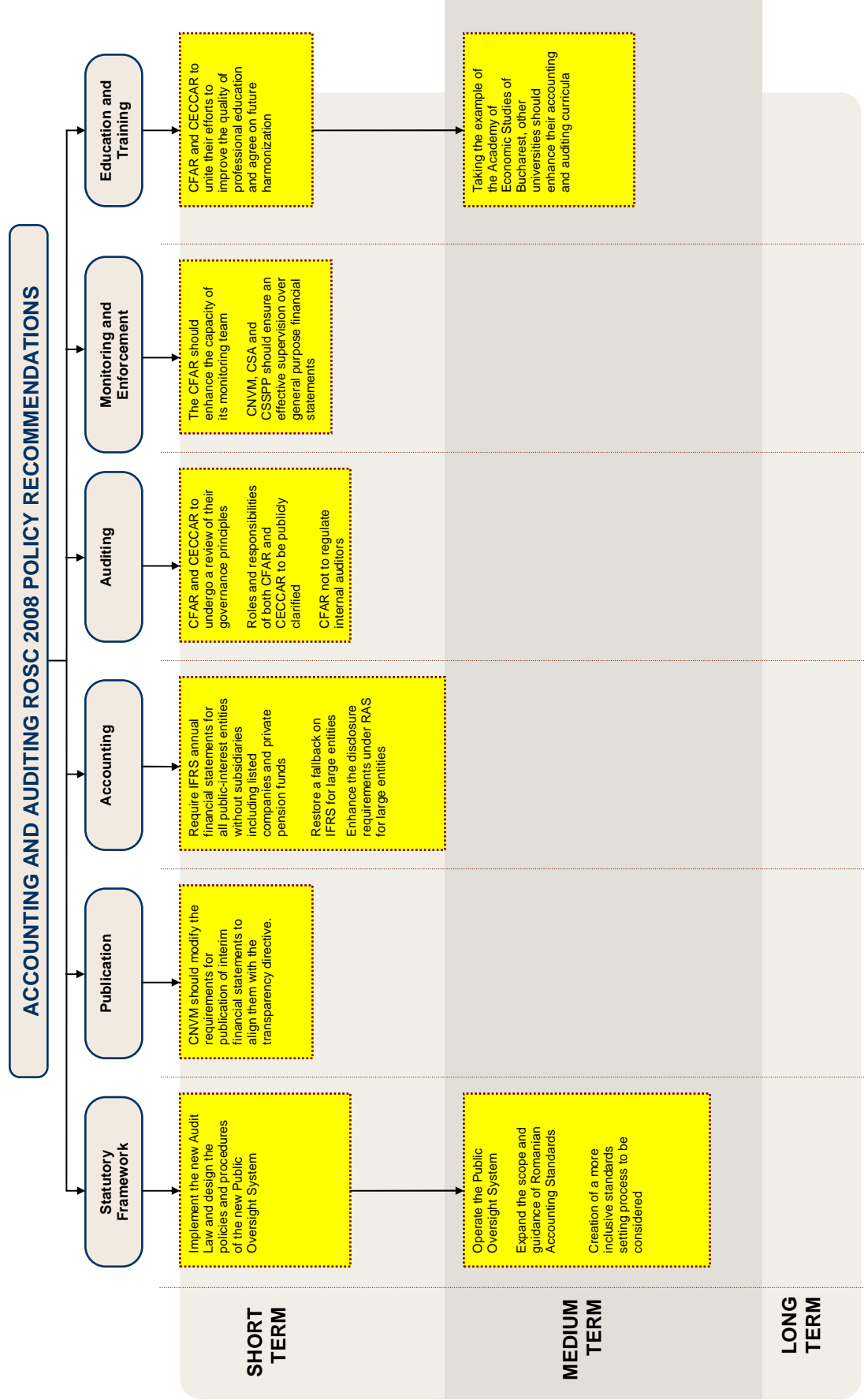
The Financial Reporting Consultative Committee should (i) review the 2003 Country Action Plan on Accounting and Auditing in light of the findings and recommendations of the present Report on the Observance of Standards and Codes, (ii) allocate responsibilities for implementation, and (iii) indicate the resources needed. The government should work to secure resources to achieve the common goal of enhancing the quality of financial reporting in Romania. The World Bank is committed to supporting Romania in this ongoing reform process.

Table 1: Progress since 2002 on Key Recommendations of the Previous A&A ROSC 2003

Key A&A ROSC 2003 Recommendations		Status as of June 2008
1.	Amend the Accounting Law, the Auditing Law, the Banking Act, the Insurance Act and the Securities Law and secondary legislation:	
	- Remove existing discrepancies and avoid future inconsistencies with IAS. ²	Partially implemented
	- Remove existing discrepancies and avoid future inconsistencies with ISA.	Implemented
	- Provide SMEs with a reporting framework more adapted to their size than IAS.	Implemented
	- Take maximum advantage of the accounting and auditing exemption in the EU Fourth Company Law Directive for SMEs when there is no public-interest requirement for the preparation, publication, or audit of financial statements.	Implemented
	- Establish a sustainable system within the appropriate body to enable (a) immediate translation and adoption of new International Financial Reporting Standards and exposure drafts issued by the International Accounting Standards Board, and new interpretations developed by the International Financial Reporting Interpretations Committee (IFRIC); and (b) to issue implementation guidelines on individual IAS that should link into IFRIC.	Implemented
2.	The supervisory institutions and/or the related laws should strive to publish financial information, as needed. Additional unpublished information needed for prudential regulatory purposes should be provided by the way of topping-up IFRS.	Not Implemented
3.	Establish a sustainable system within the CAFR (a) to enable immediate translation and adoption of new ISA and exposure drafts issued by the International Federation of Accountants; and (b) to issue implementation guidelines on individual ISA.	Implemented
4.	The supervisors (the National Securities Commission, the National Bank of Romania, and the Insurance Supervisor) should review the financial statements prepared under IFRS and take appropriate actions against those companies and their auditors, when the financial statements do not comply fully with IAS and the auditor's report has not been modified accordingly.	Partially implemented
5.	The CAFR should develop the nascent quality assurance system to ensure that auditors comply with applicable auditing and ethical standards, and independence requirements.	Partially implemented
6.	An appropriate body should be established to exercise oversight of the determination of the audit rules issued by the audit profession, the application of accounting and auditing regulations and the discipline of auditors.	Implemented
7.	Take measures to enhance the independence of the CAFR from the Ministry of Finance, including the independence in appearance.	Partially Implemented
8.	Strengthen the capacity of the CAFR by establishing twinning arrangement with a developed professional accountancy body.	Implemented
9.	Develop an accounting curriculum at colleges and universities that meets the needs of corporate Romania.	Implemented
10.	Review and update the accounting curricula in order to incorporate IAS and ISA and practically oriented teaching at the undergraduate level in higher educational institutions.	Implemented
11.	Organize additional IAS and ISA training, including practical training and coaching, for grandfathered auditors where recommended by the CAFR quality assurance review.	Implemented
12.	Implement continuing professional education that conforms with the IFAC guidelines and standards	In progress

² Since 2003, the accounting law and regulations have been amended to implement the European Union Fourth and Seventh Company Law Directives. Under the accounting standards for the enterprise sector some differences from International Financial Reporting Standards (formerly IAS) remain. Categories of entity preparing IFRS financial statements are established under various orders of the Ministry of Economy and Finance.

Table 2: A&A ROSC 2008 Policy Recommendations



MAIN ABBREVIATIONS AND ACRONYMS

A&A	Accounting and Auditing
ACCA	Association of Chartered Certified Accountants
BNR	Banca Națională a României - National Bank of Romania
BVB	Bursa de Valori București - Bucharest Stock Exchange
CAFR	Camera Auditorilor Financiari din România - Chamber of Financial Auditors of Romania
CCRF	The Council of Accounting and Financial Reporting
CECCAR	Corpul Experților Contabili și Contabililor Autorizați din România - Body of Expert Accountants and Authorized Accountants of Romania
CNVM	Comisia Națională a Valorilor Mobiliare - National Securities Commission
CPE	Continuing Professional Education
CSA	Comisia de Supraveghere a Asigurărilor - Insurance Supervisory Commission
CSSPP	Comisia de Supraveghere a Sistemului de Pensii Private - Private Pension Funds Supervisory Commission
DG MARKET	European Commission Directorate General for the Internal Market and Services
EGO	Emergency Government Ordinance
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNI	Gross National Income
IAASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standards (now IFRS)
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
ISA	International Standards on Auditing
MEF	Ministry of Economics and Finance
OECD	Organization for Economic Cooperation and Development
RAS	Romanian Accounting Standards
ROSC	Report on the Observance of Standards and Codes
SME	Small and Medium-Sized Enterprises

I. INTRODUCTION

1. This assessment of accounting and auditing practices in Romania is part of a joint initiative by the World Bank and International Monetary Fund (IMF) to prepare Reports on the Observance of Standards and Codes (ROSC). The assessment focuses on the strengths and weaknesses of the accounting and auditing environment that influence the quality of corporate financial reporting, and includes a review of both statutory requirements and actual practice. It uses International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) as benchmarks and draws on international experience and best practices. This assessment updates the findings of the previous Accounting and Auditing ROSC conducted in Romania in 2002 and published in 2003.

2. The assessment also has regard to the European Union (EU) corpus of laws (also known as the *acquis communautaire*). Since January 1, 2007, Romania has been a Member State of the EU and is obliged to comply with the *acquis*. In particular, this report benchmarks the Romanian regulatory framework and institutional capacity against the First, Second, Fourth, Seventh, and amended Eighth Company Law Directives, as well as the Transparency Directive, the IAS Regulation, and the Bank and Insurance Accounts Directives.

3. **Romania is a middle-income country with a gross national income per capita of US\$ 6,150 in 2007** (Atlas method). Romania's Growth Domestic Product (GDP) was US\$ 165.9 billion in 2007, the largest in South Eastern Europe, with important contributions from construction, services, industry and agriculture. With a population of over 21 million, it is the second largest country in Central and Eastern Europe and the seventh largest among the 27 current members of the European Union (EU). Around 55% of the population lives in urban areas.

4. **Romania's economic performance has been remarkable in recent years, although important vulnerabilities remain.** Romania steadily converges in income, competitiveness and living standards towards the EU average, but the gap remains large. In 2007, income per capita was around 40% of the EU 27 average. Since 2000, the Government implemented macroeconomic and structural policies that are supportive of growth and disinflation. A disciplined fiscal policy, complemented by a tight monetary policy and important advances in structural reform led to improved financial discipline in the enterprise sector and placed public finances and the financial system on a much firmer footing. Progress in reforms has translated into robust annual GDP growth, averaging 5-6%, for seven consecutive years. Inflation and interest rates declined steadily, the fiscal deficit was largely brought under control, foreign exchange reserves increased to historic highs and external debt was held to comfortable levels.

5. **Recently, however, internal and external imbalances have begun to widen.** Inflation has climbed to around 8.6% driven by the pick-up in food and fuel prices, robust wage growth in excess of productivity gains and credit expansion. The current account deficit has widened to around 13.7% of GDP in 2007 on the back of strong import growth and a mild slowdown in exports. The fiscal deficit has expanded to around 2.5% of GDP in 2007, up from 1.9% in 2006. Public and publicly guaranteed debt remains low, at around 13% of GDP, but private short term debt is accumulating rapidly.

6. **On January 1, 2007, Romania joined the EU.** Romania welcomed accession and was fully aware of the additional efforts needed in a number of areas to converge to EU standards and practices. Meeting the requirements of the *acquis communautaire* has been a major driver for regulatory reform. A Co-operation and Verification Mechanism was set up with specific benchmarks to help monitor Romania's progress in fighting corruption. As incentives for further reform may be weakened after accession, the EU has reserved the right to exclude Romania from

some of the benefits of the single market if progress does not match promises made during membership talks.

7. **The EU accession process constituted a solid external anchor for the transformation of the country throughout its post-communist transition.** Romania joined the EU on January 1, 2007, following the completion of negotiations in 2004 and the signing of the Accession Treaty in 2005. Nevertheless, accession to the Union and the adoption of EU standards is neither the beginning nor the end of the integration process. The reform agenda remains important and structural adjustment needs to continue to ensure sustained real and nominal convergence with the EU average. Moreover, poverty persists, with 13.8% of the population living below the poverty line in 2007. Two-thirds of Romania's poor live in rural areas.

8. **EU accession and membership have led to the gradual integration of Romania in the single market and have made the country attractive for foreign Direct Investment (FDI).** The rest of the EU is by far the largest trade partner of Romania. Currently, over 65% of Romania's trade is with other EU Member States, a figure comparable with the average intra-EU trade. Driven by strong FDI inflows, the share of goods of higher technological complexity in exports is steadily increasing. Romania is now a visible and attractive destination for international investors as a result of EU membership, better sovereign ratings and improved access to international capital markets. FDI inflows are estimated at around 9% of GDP in 2006 and 6% of GDP in 2007.

9. **Romania's accession to the EU and the robust economic growth enjoyed in recent years has triggered large and increasing shortages of labor and skills.** Paradoxically, shortages coexist with low overall participation and excess supply of labor in declining sectors, mainly in agriculture. Shortages also coexist with high unemployment for various labor categories, such as the unskilled or the young. This points towards a substantial mismatch between the skills of the workers released in the restructuring process and the visible shift in labor demand in recent years and raises questions about the relevance of education for the needs of the labor market. The employment situation has been exacerbated by a declining population, an ageing labor force and large external migration flows. Romania's population has declined by around 10% since the collapse of communism. It is estimated that over two million Romanians have left the country in search of better opportunities abroad, especially in the EU. These trends have pushed the rate of increase in wages above productivity gains, and inflated labor costs, eroding external competitiveness. Timely and coherent policy responses are needed to avoid further widening of these imbalances.

10. **In recent years, Romania has made remarkable progress in eliminating or reducing administrative and regulatory obstacles to businesses.** Since 2005, the country has advanced 30 places in the overall ranking of the ease of doing business. Romania is placed in 47th position in the world by the 2009 *Doing Business* report ahead of Slovenia, the Czech Republic and Poland, among the new EU members, though still relatively behind the EU 15 (unweighted) average. At the same time, Romania lags behind on obstacles to employing workers (ranks 143th); simplifying the procedures for paying taxes (ranks 146th), registering property (ranks 114th); dealing with licenses and permits (ranks 88th) and closing a business (ranks 85th).

11. **A private pension system was introduced in phases starting in 2006.** The Private Pension Funds Supervisory Commission (CSSPP) was established in 2007. The private pensions in Romania can be identified in two categories: privately managed compulsory pensions under a defined contributions regime and privately managed voluntary pensions on an individual basis. The first category is characterized by the channeling of a part of personal social contributions paid to the public system towards privately managed pension funds and complements the public pension system, and the second allows companies' employees, self-employed persons, civil servants and any persons earning an income from a taxable business to participate in the private

pension system on a voluntary basis. Through the end of 2007, the Commission accredited funds to receive and manage pension contributions. In May 2008, the first contributions for the mandatory pension system have been transferred to the private pension funds, making the pension market operational. The monitoring of the investments and of the quality of financial reporting will be the main challenges for CSSPP.

12. **A comprehensive reform agenda has led to the consolidation of the banking sector. At end-2007, the banking system comprised 32 banks and 10 foreign institutions' branches holding USD 100 billion in assets.** As a result of a series of important bank privatizations, including Banca Comercială Română in 2005 (one of the largest banks in the system), currently around 95% of bank assets are in private hands. The sector is dominated by foreign-owned banks from Austria, France, Italy and Greece that have brought expertise and capital into the system, creating the conditions for a more effective channeling of savings to facilitate investment. The state still fully owns one bank, CEC Bank S.A. (the savings bank), which holds less than 4% of total banking assets, and controls another bank, Eximbank S.A, which holds less than 1% of total banking assets. Reforms in the banking sector, including the strengthening of the supervision capacity of the central bank, had eased the conduct of monetary policy, although high credit growth expansion remains an important source of excess aggregate demand. While growing fast from a low base, Romania's banking sector is still small relative to the other new EU members.

13. **The contribution of the private sector to GDP exceeds 75%.** Beyond banking, important privatizations took place in the energy and manufacturing sectors. Petrom, the national oil company, as well as a number of electricity and gas distributors have been sold to strategic investors, while minority shares of the electricity and gas transmission companies have been listed on the Bucharest Stock Exchange. The Asset Recovery Agency, AVAS, has also disposed of a large share of its state owned enterprises inventory through privatization, restructuring or liquidation. As a result, the share of the private sector in GDP went up from around 61% in 2001 to over 75% in 2007.

14. **The National Bank of Romania (BNR) is responsible for the development and implementation of regulatory and financial reporting requirements applicable to the banking sector, including non-bank financial institutions.** The general provisions regarding the credit institutions sector are included in the Government Emergency Ordinance (EGO). 99/2006 regarding Credit Institutions and Capital Adequacy. Regarding non-bank financial institutions, EGO 28/2006, was issued to establish a set of minimum access conditions to engage in lending activity, as well as designing the monitoring or supervisory regime. These minimum sets of rules, aiming at ensuring that lending business is conducted on a sound and prudent basis by supervised entities, were implemented to supervising the increasing number of non-bank entities granting loans, and thus monitoring their influence on the financial market.

15. **It is important to note that there has been significant growth in the credit environment including significant increases in the granting of foreign currency denominated credit.** The proportion of loans denominated in foreign currency has risen recently to 50 per cent of all loans granted. Provisions to convert outstanding loan amounts into local currency under certain thresholds often exist in foreign currency denominated loan contracts. These provisions aim to address the potential credit risk arising from the foreign exchange risk borne by the borrowers. While the National Bank of Romania is monitoring the situation closely and requiring higher bank reserves for loans denominated in foreign currency (to curb the growth of such loans), these aspects could provide significant challenges to the National Bank of Romania in future years.

16. **The Insurance Supervisory Commission (CSA) supervises the insurance sector.** There are 40 insurance undertakings supervised and gross premiums for 2006 represent USD 2.4 billion. All insurance undertakings are privately owned and over 80 per cent of them are foreign-owned. The year-to-year growth of gross premiums was 23 per cent in real terms in 2006.

17. **Financial markets, including listed companies, are supervised by the National Securities Commission (CNVM).** Romania has now only one stock exchange: the Bucharest Stock Exchange (BVB). At end-June 2008, companies listed on the BVB had a market capitalization of RON 110 billion (USD 48 billion). The bond market was only RON 1.15 billion in corporate bonds. BVB has a total of 2,078 listed securities, 59 on the main market (BVB) and 2,019 on the unregulated market (previously known as RASDAQ). Most of the securities listed on the RASDAQ are not traded at all and are the result of the early privatization of state owned enterprises.

18. **A high quality implementation of the portions of the *acquis communautaire* relevant to the corporate financial reporting system would help Romania to improve its business environment.** The long-term benefits associated with improved corporate accounting and auditing practices include:

- Deepening the integration of Romania into the EU and the global economy through greater comparability and alignment of its standards with those applicable throughout the EU.
- Easier and cheaper access to financing for the small and medium-sized enterprise (SME) sector as a result of banks and venture capitalists having access to standardized, useful and reliable financial information that will reduce lending risk.
- Increased FDI, which can be facilitated through greater confidence in, and improved comparability of, financial information.
- Increased levels of trading on securities markets. BVB is seeking to increase its volume of trading. This can be facilitated by enhancing investors' confidence in the availability of financial information that is accurate and complete.
- Better diversification and investment opportunities for the nascent private pension industry resulting from improvements in the quality of financial reporting of listed companies fostering higher levels of trading on the stock market. In turn, this will allow pension funds to gain access to a broader choice of investments.

19. **In this context, this A&A ROSC aims to support the strategic objective of furthering the development of Romania's private sector, improving access to long-term financing for domestic enterprises, and reducing the cost of doing business in the country.**

II. THE INSTITUTIONAL FRAMEWORK FOR ACCOUNTING AND AUDITING³

A. The Statutory Framework for Corporate Financial Reporting

20. **The Statutory framework is substantially aligned with the *acquis communautaire* and endorsed IFRS implementation for consolidated financial statements is in progress for many public-interest entities.**⁴ Since 2003, the main changes to the Romanian accounting laws and regulations were made to align them with the provisions of the *acquis communautaire*, namely the Fourth and Seventh Company Law Directives, and the Bank and Insurance Accounts Directives. The Ministry of Economy and Finance (MEF) prepared the changes for the general accounting framework, while BNR and CSA modified their accounting standards for the financial sector according to the Bank and the Insurance Accounts Directives respectively. The accounting standards for the private pension industry were prepared by the newly established CSSPP with the assistance of the MEF.⁵ CNVM is responsible for issuing accounting standards for entities that it authorizes, regulates and supervises, including investment funds, brokers and investments advisors and listed companies for their individual financial statements.

21. **Law 31/1990 on commercial companies (the Company Law), republished in 2006 with subsequent amendments and supplements, regulates the business environment in Romania.**⁶ The Company Law recognizes the following types of entities: (i) limited liability companies; (ii) joint-stock companies; (iii) general partnerships; (iv) limited partnerships; (v) partnerships limited by shares; and (vi) farming companies. The Company Law defines rules and requirements on opening, managing, and closing of companies. Limited liability companies and joint-stock companies comprise up to 98 per cent of all commercial entities in Romania. As of June 2007, there were 9,976 joint-stock companies, 559,179 limited liability companies, 5,011 general partnerships, 1,782 farming companies, and 456 limited partnerships in Romania.

22. **Law 82/1991 (the Accounting Law) and the Order of the Minister of Finance 1752/2005 (OMF 1752) define the accounting and auditing obligations for the enterprise sector.** OMF 1752 provides for (i) the scope of its application, (ii) the layout of the financial statements, (iii) the content of the explanatory notes (iv) the general accounting principles and valuation rules, and (v) the general chart of accounts.

23. **The Accounting Law defines public-interest entities as:** credit institutions; non-bank financial institutions defined according to legal regulations and registered at the trade register; insurance, insurance-reinsurance and reinsurance companies; entities authorized, regulated and monitored by CSSPP; companies providing services in connection with financial investments, investment managers and mutual funds authorized by CNVM; companies having securities admitted to trading on a regulated market; national companies; and legal entities that belong to a holding group and enter into the consolidation scope of a parent company that applies IFRS.

24. **OMF 1752 defines the accounting and auditing obligations of commercial entities based on size criteria.** Article 5 requires entities that, at a reporting date, exceed the limits of

³ This report outlines the legal principles applicable with regard to accounting, auditing and financial reporting and does not attempt to give anything more than an introduction to the issues. This report is not meant to be an exhaustive rendition of the law nor is it legal advice to those reading it.

⁴ The EU requires the use of only those IFRS which have specifically been determined to be suitable for use in the EU, and has established an endorsement process to determine whether each IASB standard and IFRIC interpretation will be approved (endorsed). This led to the “carving out” of certain provisions of IAS 39 prior to its endorsement. Public-interest entities include listed companies. For a definition of public-interest entities see paragraph 23 below.

⁵ CSSPP regulates and supervises all activities related to the private pension industry and sets accounting standards for the industry including for pension funds and fund managers.

⁶ In Romania, a revised law keeps its original number and publishing date with the mention “republished”.

two of the following size criteria shall prepare a full set of financial statements and be subject to an audit: total assets of EUR 3,650,000; net turnover of EUR 7,300,000; average number of employees during the financial year of 50. A full set of financial statements comprises a balance sheet, a profit and loss statement, a statement of changes in equity, a statement of cash-flow and explanatory notes to the individual financial statements. Other companies are permitted to prepare a simplified set of financial statements comprising an abridged balance sheet, a profit and loss statement and explanatory notes to the financial statements and optionally can prepare a statement of changes in equity and a cash-flow statement.

25. All entities preparing a full set of financial statements in accordance with the above-mentioned medium sized thresholds are required to have an audit performed in accordance with ISA. In addition, the Company Law mandates an audit for joint-stock companies with a two tier board. and the Accounting Law mandates an audit for entities preparing *endorsed* IFRS financial statements, that is public interest entities. The financial auditor issues a report that addresses the shareholders as required by the Company Law. The content of the report is described in OMF 1752.

26. In addition to the requirement to be a licensed member of the CAFR, supervisors set some additional requirements for auditors.

- BNR approves the appointment of financial auditors for credit institutions. It may reject the appointment of a financial auditor if it considers that the auditor lacks adequate expertise or independence, or if it is established that the auditor failed to observe ethical rules. BNR requires also the engagement partner to rotate, albeit not providing for any rotation period.
- CSA approves the appointment of financial auditors for insurance undertakings (CSA President's Order 113105/2006). In addition to general requirements, CSA requires that the engagement partner has experience in auditing financial statements of insurance companies for at least two years. In addition, the audit team shall include at least one actuary.
- CNVM has signed a Memorandum of Understanding (MoU) with CAFR, with regard to the quality assurance process for external audits of entities which CNVM authorizes, regulates and supervises. CNVM can request CAFR to conduct on-site inspections of audit files and reports issued by financial auditors. In addition, in accordance with Order 297/2004, financial auditors of entities supervised by CNVM shall be members of CAFR, and comply with CPE requirements.
- CSSPP standards 11/2007 and 8/2006 require supervised entities, including pension funds, to appoint financial auditors or audit firms that are members of CAFR and to rotate those financial auditors or audit firms every five years.

27. The Accounting Law establishes the responsibilities of the MEF and supervisors in establishing accounting standards. While the primary responsibility for corporate financial reporting in Romania lies with the MEF, specialized supervisors issue regulations for their sector, including accounting standards. The MEF establishes the enterprise sector accounting standards, Romanian Accounting Standards (RAS), including a general chart of accounts and standard format of financial statements. In addition, the accounting standards for credit institutions, insurance undertakings, pension funds and entities operating on the capital market are prepared by BNR, CSA, CSSPP, and CNVM, and issued by these institutions after endorsement by the MEF. The Accounting Law regulates accounting for public and private sector entities, including accounting procedures and requirements, filing of accounting records and mandatory accounting books, consolidated financial statements, publication of financial statements, and minor offenses and sanctions.

28. Supervisors set the accounting standards for individual financial statements of the entities they supervise:

- BNR sets **banking accounting standards**. For credit institutions, including banks, order 5/2005 transposes the Bank Accounts Directive, and stipulates that credit institutions and non-bank financial institutions must prepare their individual financial statements in accordance with the Bank Accounts Directive and their consolidated financial statements in accordance with *endorsed* IFRS.
- CSA sets **insurance accounting standards**. CSA Order 3129/2005 with subsequent amendments and supplements (CSA Order 7/2007) transposes the Insurance Accounts Directive and stipulates that insurance undertakings must prepare their individual financial statements in accordance with the Insurance Accounts Directive. Consolidated financial statements must be prepared in accordance with either *endorsed* IFRS or accounting standards compliant with the Seventh Company Law Directive.
- CSSPP sets **pension accounting standards**. Norms. 14/2007 and 18/2007 regulate the pension plans and pension managers accounting standards in accordance with the Fourth and Seventh Company Law Directives respectively. Consolidated financial statements must be prepared in accordance with either *endorsed* IFRS or accounting standards compliant with the Seventh Company Law Directive.
- CNVM Orders 75/2005 and 74/2005 transpose respectively the Fourth and Seventh Company Law Directives for companies that the CNVM regulates and supervises. Listed companies regulated by CNVM prepare their consolidated financial statements under *endorsed* IFRS.

29. **The Accounting Law sets the obligations to prepare consolidated financial statements for a parent company and OMF 1752 provides for exemptions.** Entities other than public-interest entities are exempt from preparing consolidated financial statements if, at balance sheet date, the entities to be consolidated do not together exceed the limits of two of the following three criteria: total assets of EUR 17,520,000; turnover of EUR 35,040,000; and average number of employees during the financial year of 250. A group (if not a listed entity) may be exempt from preparing consolidated financial statements if more than 90% of the parent company belongs to another group. Public-interest entities, other than banks and listed companies, prepare their consolidated financial statements in accordance with either *endorsed* IFRS or accounting standards compliant with the Seventh Company Law Directive.

30. **Banks and listed companies prepare consolidated financial statements under *endorsed* IFRS.** The provision of OMF 907/2005 providing that banks have to prepare a set of consolidated financial statements in accordance with IFRS for the year ending 31 December 2006 has been confirmed by OMF 1121/2006 for subsequent periods (however in accordance with *endorsed* IFRS). In addition, OMF 1121/2006 also establishes *endorsed* IFRS as the mandatory accounting standards for consolidated financial statements of listed companies starting 2007.

31. **Banks and listed companies without subsidiaries are not required to prepare individual financial statements under *endorsed* IFRS.** This leads to a potential lack of comparability among listed entities and banks; while parent companies prepare consolidated financial statements under IFRS, other banks and listed companies without subsidiaries prepare financial statements under RAS.

32. **According to the Accounting Law, insurance undertakings provide consolidated financial statements using either *endorsed* IFRS or insurance accounting standards that are a transposition of the Insurance Accounts Directive.** No consolidated financial statements were prepared under IFRS by insurance companies for 2006. CSA should require all insurance companies to publish financial statements prepared under *endorsed* IFRS as these are public interest entities. CSA should leave open, however, the possibility for insurance companies to

complement provisions of IFRS 4 with other accounting standards. At present, IFRS 4 – Insurance Contracts is incomplete and some insurance undertakings include US GAAP provisions in their accounting policies to the extent those are consistent with IFRS 4.

33. **Under the Accounting Law 82/1991, the manager or chairman of the board is responsible for the preparation of the company’s financial statements.** The manager or chairman of the board issues a statement of responsibility for the preparation of the individual financial statements, both statement of responsibility and financial statements being signed. They are also required to prepare a report on the operations of the entity.

34. **Financial statements are presented for approval at the General Assembly of the Shareholders,** which is to be held within 150 days after the reporting date. For listed entities the requirement for approval and submission is within 120 days after the reporting date. For non-listed entities, consolidated financial statements should be approved within 8 months of the year end.

35. **Both the Accounting Law and the Company Law republished require all legal entities to publish their individual financial statements within 150 days of the reporting date.** The Company Law also requires financial statements to be sent to the trade registry within 15 days of the General Assembly meeting. Companies regulated by CSA are required to submit their financial statements within four months of the financial year-end. Credit institutions are required to submit their financial statements within 150 days of the year-end. Companies regulated by CNVM are required to submit their financial statements within 120 days or 150 days depending on the type of business of the company as authorized by the CNVM. The Company Law obliges the Management Board of the parent company to publish **the annual financial consolidated statements** at the trade registry **within 15 days from the date of their approval.**

36. **The Accounting Law republished, states in Art 42 that if a company fails to publish its financial statements it is subject to a fine between RON 2,000 to RON 30,000.** In addition, the Company Law republished, states that on request from any interested party or the National Trade Registry Office, a court may dissolve a company when it does not submit its individual financial statements within six months from the expiry of the legal time limits.

37. **In Romania, the availability of both individual and consolidated financial statements at the trade registry is good.** Since 2003, considerable progress has been achieved in respect of the availability of financial statements at the trade registry. Full financial statements are available for a fee which represents not more than the administrative cost. In addition, the Trade Registry has contracted with data companies that commercialize companies’ financial statements data.

38. **Companies listed on the Bucharest Stock Exchange are required by CNVM to file and publish quarterly and half-year aggregate financial information prepared under RAS for the parent company only.** This results in the shareholders of a listed parent company receiving quarterly financial information that is inconsistent with the consolidated financial statements prepared in accordance with *endorsed* IFRS. Quarterly information is not required by the Transparency Directive, which requires only half-year information. The following table summarizes the reporting requirements and the accounting standards used for listed companies.

REPORTING REQUIREMENTS FOR LISTED COMPANIES—PERIODICITY	IFRS	RAS
Consolidated financial statements of the group—Annually and Semi-Annually	√	
Individual financial statements of a single entity—Annually and Semi-Annually		√

39. **Companies that have their shares listed on the BVB publish their financial statements electronically.** While BVB makes key financial figures of listed companies available on its website, it also provides a link to websites of companies listed on the main market. These websites provide the financial information of the company including the latest financial statements.

40. **On November 11, 2008, the Romanian Parliament enacted Law 278/7 approving EGO 90/2008 (the amended Audit Law). EGO 90/2008 was issued on June 24, 2008 to implement the new provisions of the amended Eighth Company Law Directive into Romanian legislation.** EGO 90/2008 on statutory audit introduced a public oversight system through the establishment of the Council for the Public Oversight of the Statutory Audit Activity. The oversight body will perform primarily a supervisory function (will have “ultimate responsibility”) and CAFR will maintain many of its existing functions, including those relating to education, registration, quality assurance, investigation and discipline. The new law contains a provision stating that the Council for the Public Oversight of the Statutory Audit Activity is an “autonomous and independent body ... subordinated to the Romanian government”. The institutions to be represented on the Supervisory Board of the Council for the Public Oversight of the Statutory Audit Activity have designated their representatives, except for CNVM, which does not want to participate. The Supervisory Board is required to adopt regulations for the organization and functioning of public oversight within six months of issuance of the regulation. The new Audit Law complies with the amended Eighth Company Law Directive. It includes provisions for (i) licensing, (ii) initial and continuing professional education (iii) a public register of auditors and audit firms, (iv) transparency report requirements (v) a quality assurance system, (vi) investigation and penalties, and (vii) auditor’s liability. In addition to the requirements of the directive, the new Audit Law confirms CAFR’s adoption of the IFAC Code of Ethics and ISA.

41. **While EGO 90/2008 implements the provisions of the amended Eighth Company Law Directive, recommendations of the European Commission on external quality assurance for statutory auditors and audit firms auditing public interest entities, and on limitation of auditors' liability, published in May and June 2008, are not included in the Audit Law.** The Romanian authorities may wish to consider amending legislation and issuing new regulations to implement these recommendations. EGO 90/2008 gives the ultimate responsibility to the public oversight body, but leaves with CAFR the approval and registration of statutory auditors and audit firms, continuing education, quality assurance and the review process thereof. The public oversight body will be directly responsible for disciplinary and investigative systems. The EC Recommendation on external quality assurance for statutory auditors and audit firms auditing public interest entities recommends inter alia that (i) the public oversight system should have an active role in the quality assurance of statutory auditors and audit firms involved in the statutory audits of public interest entities, (ii) audit practitioners should not have a leading role in the inspections systems and inspections teams, and (iii) transparency on the outcomes of the inspections should be enhanced in order to improve accountability of the inspection system towards investors, companies and other stakeholders.

42. **Although the new Audit Law has been enacted, it still needs to be implemented. In particular, the Public Oversight Body still has to commence operations.** The authority under which the Public Oversight Body will be placed will have a bearing on the pay scale of its staff. One of the main challenges is to provide appropriate remuneration to attract skilled individuals at the executive and technical levels.

43. **This table summarizes the reporting and publication obligations for corporate sector entities:**

Entities	Individual financial statements	Consolidated financial statements	Audit Requirements	Publication
All companies defined under the Company Law and under the size criteria	Simplified set of financial statements under RAS	Either RAS or <i>endorsed</i> IFRS Exempted if under the thresholds for consolidation	Only for consolidated financial statements when applicable	Trade Registry
All companies defined under the Company Law and above the size criteria	RAS	Either RAS or <i>endorsed</i> IFRS Exempted if under the thresholds for consolidation	Yes	Trade Registry
Joint-stock Companies with a two tier board	RAS	Either RAS or <i>endorsed</i> IFRS Exempted if under the thresholds for consolidation	Yes	Trade Registry
Listed Companies	RAS	<i>Endorsed</i> IFRS	Yes	Trade Registry
Banks	Bank accounting standards	<i>Endorsed</i> IFRS	Yes	Trade Registry
Insurance companies	Insurance accounting standards	<i>Endorsed</i> IFRS or RAS	Yes	Trade Registry
Private Pension Funds	Pension accounting standards	<i>Endorsed</i> IFRS or RAS	Yes	Trade Registry
Other public-interest entities	RAS	<i>Endorsed</i> IFRS or RAS	Yes	Trade Registry

B. The Accounting and Auditing Profession

44. **The accounting and auditing profession in Romania is organized under two separate bodies:** the Chamber of Financial Auditors of Romania (CAFR), whose members are licensed to perform financial statutory audit as defined under the new provisions of the amended Eighth Company Law Directive; and the Body of Expert and Licensed Accountants of Romania (CECCAR).

- CAFR was established in 1999 under the provisions of the Audit Law (Emergency Government Ordinance 75/1999—EGO 75/1999), which was subsequently approved by Law 133/2002. The conduct of statutory audits of financial statements is restricted to licensed financial auditors, members of the CAFR (either an individual or a legal entity meeting ownership requirements). CAFR has approximately 2,400 individual members and 760 firm members. Audit firms include member firms of international audit firm networks, as well as local firms and sole practitioners.
- CECCAR is a self-regulating body created in 1994 by the Ordinance 65/1994. It is the regulatory body for certified expert accountants and authorized accountants and was the only professional accountancy body prior to 1999. Membership is mandatory for accountants in public practice. There are over 20,000 CECCAR members.

45. **The establishment of the new financial audit function and the restriction of audit services to member of CAFR have resulted in a strained relationship between the two**

organizations, even though up to 90% of CAFR members are also CECCAR members and a cooperation agreement has been drafted. Cooperation between CECCAR and CAFR is much needed to meet the demand for high quality accounting and auditing services and to enhance the international visibility of the Romanian accounting and auditing profession.

46. **A tradition of protecting shareholders' interests has existed since 1877 when censors were first introduced to monitor the management of companies.** Censors are appointed by the shareholders of the company and one is required to be a member of CECCAR. For example, a joint-stock company will have three censors and the same number of substitute censors. Censors may be shareholders, except for the censor who is a professional accountant, i.e. member of CECCAR. When the entity is audited by a financial auditor, member of CAFR, there is no longer any obligation for shareholders to appoint censors. Censors' obligations are stated in Article 163 of the Company Law, whereby censors must monitor the management of the company, check whether the financial statements have been duly prepared and are in compliance with the books and records, and whether a physical count of the assets took place for the preparation and presentation of the financial statements. As one of the company's censors is required to be a member of CECCAR, CECCAR has issued a standard further describing working procedures for censors.

47. **Although the differences between the roles and responsibilities of financial auditors and those of censors appear to be clear to Romanian stakeholders, the difference is less clear for an international audience.** Some censors refer to their report as the audit report of the censors. Finally, in some instances (e.g., IFAC's Statement of Membership Obligations questionnaire), it has been communicated internationally that the censors perform "SME audits".

48. **Both CECCAR and CFAR are now full IFAC members, as CFAR was granted full membership by IFAC in November 2008.** Both associations have provided an action plan to IFAC with a view to strengthening the functioning of their associations; these action plans will need to be implemented thoroughly.

49. **70 per cent of the auditors were licensed under a transitional regime, upon passing an examination of professional competence organized by CAFR at its inception.** Most of these auditors had fifteen years of experience in finance and accounting at the date of effectiveness of the Government Ordinance 75/1999 and were provisionally admitted and then licensed upon passing an examination of professional competence organized by CAFR. Some 817 candidates were admitted as members of CAFR in October 2000 and a further 603 in June 2001. Some CECCAR members took the opportunity of the transitional regime to access CAFR membership, resulting in many CAFR members being also CECCAR members.

50. **Although both of the professional bodies have changed their governance principles in recent years, the governance arrangements and practices of CECCAR and CAFR are not widely known or understood.** Therefore, an independent reviewer should review the governance arrangements of both bodies. This review should be subsequently published together with the planned implementation of the report's recommendations.

51. **EGO 75/1999, amended in 2003 and in force until June 24, 2008, recognizes CAFR as a self-regulated professional association with the government having a supervisory function** to the extent of taking legal action in case of a CAFR regulation that contradicts the law. Consequently, CAFR has, *inter alia*, authority over the quality assurance review program (external quality assurance), as well as investigation and disciplinary functions. In addition, CAFR had the following mandate:

- to make recommendations on harmonizing Romanian legislation with that of EU and relevant international professional standards;

- to organize and conduct professional examinations;
- to organize and monitor continuing professional education;
- to maintain a register of auditors and audit firms;
- to develop a professional code of ethics for members; and
- to develop, where necessary, audit guides and techniques.

EGO 75/1999 will be aligned with the provisions of EGO 90/2008 on statutory audit and the amended Audit Law (See Para. 40-41) within a nine month period from the publication EGO 90/2008.

52. CAFR has stricter guidelines for auditor independence than most EU Member States. Article 32 of the CAFR's by-laws specifically precludes auditors from accepting any non-audit work from audit clients.

53. EGO 75/1999 also sets certain requirements in relation to internal audit⁷, including the provisions requiring internal audit managers to be CAFR members and requiring CAFR to develop internal auditing standards. These provisions created jurisdictional difficulties following the establishment of the Romanian chapter of the Institute of Internal Auditors (IIA) in 2004 and its accreditation by the IIA in 2006. At the time of completion of this report, these provisions were still in effect, even though IIA Romania counted 26 CIAs (Certified Internal Auditors) and 4 CGAPs (Certified Government Audit Professionals) among its members.

54. Since 2003, CAFR has developed a quality assurance and review program. The department for monitoring and professional competence currently operates with 7 staff (5 inspectors and 2 junior inspectors) under the responsibility of a licensed auditor. The inspectors benefited from intensive training with experts from the Institute of Chartered Accountants of Scotland (ICAS), mainly during 2003 and continuing in 2004. An important part of this course was dedicated to IFRS and ISA. However, quality reviews last only one to two days on average and are performed by inspectors who do not have significant auditing experience. Two of the inspectors are ACCA (the Association of Chartered Certified Accountants) students, and five are now qualified Financial Auditors.

55. The composition of the monitoring team needs to be strengthened in order to accomplish the full scope of inspections required by CAFR Decision 70/2006⁸:

⁷ Requirements applicable to internal audit are also included in the ordinance 37 of January 29, 2004 that amends and supplements the internal audit regulations published in the Official Gazette, Part I 91 of January 31, 2004.

⁸ CAFR Council Decision 70/2006, the inspections consist of:

- understanding auditing and related services activities by examining contracts on financial audit, internal audit and other services offered by CAFR members, and the compliance of these activities with relevant ISA;
- verification of financial auditors activities with information provided in their annual license application; including financial audit and other activity revenues, and integral and timely payment of the fees and other obligations towards the Chamber;
- fulfillment of training obligations by financial auditors that obtained unsatisfactory results during monitoring reviews;
- verification of the existence within the audit firm/ individual auditor of a quality control system
- assessment of the quality control system in conformity with ISA and with the Code of Professional Ethics independence requirements;
- verification of development by the audit firms of quality assurance review procedures specific to audit engagements for the audit of listed entities' financial statements;

- While the monitoring unit appears to have received proper education and training, its members have minimal professional experience as auditors. The lack of practical auditing experience might impede their ability to review audit files, particularly for banks and insurance undertakings. One possibility would be to include in monitoring teams, on an ad hoc basis, financial auditors with experience in these fields.
- Further, the average time allocated to the quality assurance review amounts to one or two days. The duration of individual reviews should be significantly lengthened to better review the quality of the audit work performed by auditors. In the coming years, CAFR could consider limiting the frequency of its reviews of auditors not involved in public-interest entities to only every six years and focus on improving the quality of those reviews. Under the amended Eighth Company Law Directive, auditors of public-interest entities should be reviewed at least every three years.

56. **Financial auditors are required by CAFR to carry professional liability insurance.** Since 2005, professional liability insurance requirements for financial auditors have changed: CAFR Board's decision 45/2005 updates the obligation of auditors to carry professional liability insurance to require coverage for the value of their professional risk as defined in contracts with their clients or, when not defined contractually, an amount of two times their gross audit fees. Some audit firms include disclaimer provisions within their engagement letters limiting their liability (e.g., liability capped at the level of the audit fees). Romanian lawyers contend that contractual liability limitations embedded in the audit engagement letters would not be recognized by the courts, although this has never been tested.

C. Professional Education and Training

57. **In line with the general shortage of skilled labor, there is a shortage of accounting graduates and qualified accountants.** Auditing firms' staff turnover is historically high and it often happens that a graduate with only two years of experience with a member firm of an international audit network is offered a managerial position in an accounting or financial department of a corporation for a significant salary increase. There is a clear need for universities to increase their capacity to produce graduates to meet the market demand.

58. **A financial auditor must have acquired appropriate higher education, obtained relevant practical experience, and passed the CAFR examination.** The requirements were eased in 2007 and graduates majoring in accounting have their pre-training period work experience requirement shortened to two years. Before this change, university graduates had to work and study for 7 years before they were eligible to be a licensed financial auditor. EGO 75/1999 (amended 2003) complies with the new Eighth Company Law Directive and, in some instances, has even stronger requirements (pre-training period requirements), by requiring an auditor to accomplish the following:

- To qualify as a trainee: Acquired higher education in economics and four years of prior experience or the title of Expert Accountant; passed knowledge tests in the financial and accounting area.
- To qualify as a financial auditor: Obtained three years additional practical experience in auditing under the supervision of an auditor with an average of 75 days per year, 25 days in accounting, 25 days on auditing and 25 days on related topics; passed CAFR

- inspection of the working papers of financial statements audit engagements in order to assess compliance with professional standards and with regulatory and legal requirements and observance of the provisions regarding financial audit performance, in accordance with the Chamber's minimum audit requirements and the ISA.

examination which includes financial audit, general accounting, analysis of financial statements, consolidation, cost accounting, internal audit, accounting standards, auditing standards, and commercial law.

59. **To become an Expert Accountant and full member of CECCAR**, the candidate must obtain an economics degree, pass an entry examination, acquire 3 years of work experience under the supervision of a mentor, complete a certification program, and pass a final examination.

60. **CAFR strictly enforces minimum continuing professional education (CPE) requirements for its members.** Under Council Decision 9/2001, CAFR requires members to participate in a minimum of 40 hours CPE annually, 20 hours of which must be organized or approved by CAFR. CAFR operates its own CPE programs but CAFR members may attend CPE programs offered by other institutions for the remaining 20 hours. CAFR has signed a CPE recognition agreement with the ACCA and is currently negotiating a similar agreement with CECCAR. The agreement on CPE provides for mutual recognition of the training programs. The CPE program is strictly enforced and auditors' licenses are suspended if they do not attend the required 40 hours for two consecutive years. The suspension of the license is made public on CAFR's website.

61. **CAFR does not recognize the CECCAR qualification.** Both bodies have sound and similar initial education and CPE requirements, however, the quality of delivery of training and professional education could not be assessed.

62. **The Academy of Economic Studies of Bucharest in strengthening its syllabus for accounting graduates provides an example for other universities in Romania to follow.** The recognition of the strengthening of this syllabus is evidenced by the number of examination exemptions granted by the UK-based ACCA. ACCA has increased the number of exemptions to graduates in accounting and auditing from this academy from four to nine, the total number of ACCA examinations being fourteen.⁹ In addition, since the ACCA qualification is recognized by CAFR and CECCAR as a basis for granting exemptions from their professional examinations, future graduates in Accounting at the Academy of Economic Studies of Bucharest may be more attracted to public practice. Finally, member firms of international audit networks in Romania require their staff to take the ACCA program. Still, both enterprises and audit firms seek further improvements for more practically oriented curricula through the involvement of practitioners at universities and internship programs.

D. Setting Accounting and Auditing Standards

63. **The accounting standards setting process in Romania is overseen by the MEF.** The MEF sets the accounting standards for the enterprise sector, RAS. Main accounting pronouncements are discussed in the Council of Accounting and Financial Reporting (CCRF). CCRF includes key supervisors and stakeholders of the Romanian financial and regulatory system. CCRF is chaired by MEF and includes BNR, CNVM, CSA, CSSPP, Ministry of Justice, CAFR, CECCAR, representatives of academe, and representatives from professional associations in the enterprise sector. It does not involve, however, representatives of the banking and insurance industries, nor preparers or users of financial statements, or technical staff of member firms of international audit networks.

64. **As compared to the former OMF 94/2001 on accounting standards for the enterprise sector, the explicit reference to IFRS was deleted in OMF 1752.** The absence of a reference to IFRS when RAS does not provide detailed guidance is seen as an issue by the

⁹ ACCA provides an internationally recognized accounting and auditing qualification

accounting and auditing profession and preparers. Under the former accounting regulation IAS/IFRS applied unless another specific treatment was indicated. Under the new accounting regulation there is no explicit link to IFRS.

65. **The consultation process for issuing accounting regulations could be enhanced.** There is a lack of effective consultation with preparers, auditors, and users of financial statements. This may have contributed to inadequate time being provided to financial statement preparers to implement new or amended accounting standards. For example, in some instances, regulations that have been issued after year end, require application to the previous year's financial statements. In other instances, some inconsistencies in accounting pronouncements were noted and such pronouncements were subsequently withdrawn. A consultative process may also not be effective when regulated entities are under the impression that their opinion does not influence the body that regulates and supervises them.

66. **The new Audit Law mandates the use of ISA. Prior to June 24, 2008, EGO 75/1999 required CAFR to adopt auditing standards and ISA were adopted by CAFR.** The CAFR Council had adopted ISA as of 2006. Since 2007, new standards issued by IFAC are part of the clarity project and will be applicable only in 2009.¹⁰ The responsibility for translation of ISA is with CAFR, and standards are translated on an annual basis.

67. **In Romania, both the CAFR and the CECCAR have independently translated all ISA and the IFAC Code of Ethics for the purposes of their respective activities.** A single high quality translation of ISA and the IFAC Code of Ethics standards for Romania would reduce confusion as to the source and availability of applicable standards and eliminate differences in terminology that may exist in multiple translations. For example, the CECCAR translation refers to the "Handbook of International Auditing, *Certification*, and Ethics Pronouncements", while the CAFR uses "Handbook of International Auditing, *Assurance*, and Ethics Pronouncements". Multiple translations waste scarce resources and are the ultimate example of a lack of cooperation between the two professional bodies. Full cooperation between CECCAR and CAFR is needed to avoid multiple translations and agree on the terminology to be used.

68. **In February 2008, the Board of IFAC approved a proposal to move to one high quality translation of the IFAC standards per language.** Under former policies, IFAC does not: (i) limit the number of translations of the same publication into the same language, (ii) review the quality of translations conducted by third parties, or (iii) require translation bodies to update the translations on a regular basis.

E. Enforcing Accounting and Auditing Standards

69. **CAFR's policy is to review each registered auditor and audit firm at least once in every three years.** The reviews cover both auditors' policies and procedures and individual audit files. Review results are expressed using a scoring system (from D to A) based on compliance with the relevant requirements (from 0% to 100%).

Percentage	< 35%	36% to 60%	61% to 80%	81% to 100%
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¹⁰In seeking continually to improve its standards, the IAASB undertook in 2003 to review the drafting conventions used in its International Standards. The objective of the review was to identify ways to improve the clarity, and thereby the consistent application, of International Standards issued by the IAASB. The scope of the clarity project includes both establishing the conventions to be used by the IAASB in drafting future ISA's and establishing the obligations of auditors who follow those Standards and applying those conventions to all of the ISA's, either as part of the substantive revision of an ISA or limited redrafting to reflect only the agreed upon conventions and matters of clarity generally. This project has been completed in 2008.

Auditors' ranking	D	C	B	A
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70. **The table below summarizes the results of CAFR's inspections between 2005 and 2007.** Ratings have improved over the last three years.

Rating	2007		2006		2005	
	No	%	No	%	No	%
A	120	37%	58	29%	56	30%
B	152	47%	57	28%	47	26%
C	52	15%	72	36%	69	37%
D	2	1%	14	7%	12	7%
Total	326	100%	201	100%	184	100%

While weaknesses in the review process have been noted above and the effectiveness of the quality assurance system cannot be assessed directly from these results, there are direct and indirect incentives for auditors to improve the quality of their work. Auditors who obtain a D, C, or B grade are subject to annual quality review. Some regulators require an A or B grade when authorizing auditors to perform audits of supervised entities. In 2006 a notification sanction was issued to 65 financial auditors assessed at a C grade following an inspection and a warning sanction was issued to 11 financial auditors assessed at a D grade. Sanctions were lifted after the Chamber identified measures being taken to alleviate identified non-compliance issues. In 2008 a six-month suspension has been decided for two financial auditors who had denied access to the CAFR Inspectors to their files, and for unethical activity. It should be noted, however, that no auditor has so far been excluded from the profession for poor quality audit work.

71. **While auditors are subject to civil, disciplinary, administrative, and criminal sanctions, there have been no civil or criminal cases against auditors.** Auditors' civil liability is subject to the general rules regarding liability under the Romanian Civil Code (i.e., only actual damages, no consequential damages).

72. **In general, supervisors focus more on the monitoring of prudential criteria rather than on financial reporting.** The auditor's report is still the main source of information on compliance with accounting standards. However, monitoring staff are often trained to review financial statements although it is not the primary area of focus of their work.¹¹

- **BNR monitors and enforces compliance with financial and accounting requirements, including accounting standards.** In the case of a qualified audit report, BNR assesses the reasons triggering the qualified opinion and an in-depth analysis is made during the next on-site visit by the monitoring department. During an on-site visit the financial statements are reviewed. In-depth reviews of material items on the balance sheet and the profit and loss account are performed using a risk-based approach. The BNR supervision department comprises eight staff dedicated to on-site inspections on financial and accounting requirements. In the last five years, BNR has imposed fines on banks' managers (7) and on banks (2), has issued a warning to a bank (1), and taken additional steps (1), with respect to financial reporting issues.
- **The focus of the CSA monitoring department appears to be more on prudential requirements than on financial reporting.** No instances of non-compliance with financial

¹¹ Financial statements for private sector pension funds will be prepared for the first time as of December 31, 2008; the first contributions to private sector pension funds were made in 2008.

reporting requirements were communicated or published. Compliance breaches with respect to regulations issued by CSA are published in their annual report.

- **The CNVM monitoring unit reviewing listed companies' financial statements counts six staff members** that have been trained, notably on IFRS, under an EU-funded project (Phase 2005 "Strengthening the institutional capacity of the CNVM"). The EU-funded project also contributes to defining the operational procedures of the monitoring unit. The monitoring unit commenced its activities in late May 2008 and will *inter alia* review consolidated financial statements of listed companies' prepared under *endorsed IFRS*. The rapid implementation of the knowledge gained during the EU project to ensure an effective review of financial statements under IFRS will be a challenge for the newly established unit.

73. **While sanctions foreseen under the Securities Law include civil liability for preparers, directors, and auditors, no court case has been reported to date.** The BVB reviews financial statements of listed companies for missing documentation but, in the absence of a thorough review of the annual reporting, including the financial statements and the audit report, it does not assess the quality of the information provided by listed companies. In addition, it is the duty of CNVM to monitor and enforce the financial reporting of listed companies. CNVM has never ordered restatements and has only levied fines for late filing.

III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

74. **The comprehensiveness of Romanian Accounting Standards for the enterprise sector is challenged by sections of the accounting and auditing profession.** Although Romania has implemented the relevant accounting directives, the absence of many elements of the necessary supporting infrastructure, combined with Romania's rule-based accounting traditions, present challenges in ensuring that the principles contained in European Union legislation are applied in a manner that leads to high quality financial reporting. Auditors and preparers indicated instances of unacceptable variation in how enterprises account for similar transactions and insufficient disclosure to provide users with insight into the impact of these differences, as some Romanian companies tend to comply with only the minimum requirements of RAS, restricting disclosures to only those explicitly mandated. The Fourth Directive, which is the basis for Romanian requirements, establishes fundamental principles relating to financial reporting but it does not deal explicitly with all financial reporting issues. Further, it presupposes the existence at Member State level of certain accounting conventions, education, training, standards and guidance to support high quality financial reporting. Effective implementation of the principles in the Fourth Directive will require significant reforms to establish the necessary human and institutional capacity. As these reforms are undertaken, the MEF should also consider enhancing RAS to make them more comprehensive in their coverage of financial reporting issues and supplementing the standards with authoritative guidance. While the MEF has issued a practical guide on the application of Accounting Regulations which provides monographs and examples and explains the functioning of the chart of accounts, this guide does not carry any authority and thus, cannot be enforced by auditors.

75. **Key differences between IFRS and OMF 1752/2005 are listed below:**

	IFRS	RAS
Deferred taxes	IAS 12 —Deferred taxes relating to all temporary differences need to be recognized	No requirement to recognize deferred taxes. A deferred tax liability may be recognized through a provision posted under ‘provisions’ on the face of the balance sheet.
Financial Instruments	IAS 32, 39 —Financial Instruments IFRS 7 —Financial Instruments disclosures	Mention of the treatment of financial instruments but in a very limited way
Inventories	IAS 2— Permits only the first in first out (FIFO) method or weighted average cost formula	In addition to the methods permitted under IFRS to calculate the cost of inventories, the last-in first-out (LIFO) inventory method is permitted
Business combinations	IFRS 3—Specific requirements including fair valuing of acquiree’s net assets to determine the amount of goodwill and subsequent measurement of impairment of goodwill	Acquired assets are not recognized at fair value Goodwill is amortized
Foreign Currency Translation	IAS 21—Valuation of monetary items at the exchange rate at the reporting date	Monetary items are revalued only at year-end using foreign exchange rates published by BNR. There are no forex adjustments for interim financial statements
Depreciation of fixed assets	IAS 16—Based on the useful life of assets	Accelerated depreciation is allowed
Asset dismantling costs	IAS 16—Required to be recognized as a part of the cost of an asset based on a present value of future cash outflows relating to a dismantling activity	Dismantling costs can be recognized but discounting future cash outflows relating to dismantling activity is not required.
Impairment of assets	Detailed requirements specified in IAS 36 including the Cash Generating Unit concept	No Cash Generating Unit concept under RAS which may lead to different impairment outcomes when compared with IAS 36
Assets held for sale	To be accounted for in accordance with IFRS 5	Not specified
Leases	IAS 17—Lease payments are required to be spread over the lease period	No specific treatment of one off lease payments or lease holidays
Discounting of long term liabilities	IAS 37 and IAS 39—Discounting required	Discounting not required
Employee benefits	Detailed requirements specified in IAS 19, including a description of the methods to be used for employee benefits calculations	Calculation methods are not specified in detail. Instead, the use of a “specialist” is required. There are no other specific requirements to provide for employee benefits
Corrections of prior year errors	IAS 8—Retrospective treatment (prior year balances need to be changed)	An error is recognized through Retained Earnings; however, the prior year balances are not restated

76. **RAS also provide little or no information on matters covered by the following IFRS:** IFRS 2 Share-based payment; IFRS 6 Exploration for and Evaluation of Mineral Resources; IFRS 8 Segment Reporting; IAS 40 Investment Properties; and IAS 41 Agriculture.

77. **The lack of a compliance culture in Romania for financial reporting is slowly changing.** The audit profession believes all preparers should aim to prepare financial statements

that would receive unqualified audit opinions. The audit profession notes, however, that qualified audit opinions and even disclaimers of opinion are not always seen as major problems, preparers being more focused on compliance with tax requirements. For example, a company with a qualified audit opinion may distribute dividends to its shareholders even though the profit or retained earnings of the company, if adjusted, may be materially lower (or negative) than the amounts reported in the company's financial statements. The profession indicated that the situation is slowly changing because foreign owned and newly listed companies are believed to pay more attention to ensuring their financial statements are free of material errors.

78. **In companies required to prepare IFRS consolidated financial statements, preparers showed a good understanding of the standards.** Large and foreign owned companies (often the same) seem to have processes (including training) in place to prepare financial statements in accordance with IFRS. Heads of financial and accounting departments of recently acquired companies are generally specialists sent to new subsidiaries. While preparers that produce financial statements under both RAS and IFRS, believe this represents an additional unnecessary burden, both financial reporting frameworks are said to be prepared with the same high level of diligence.

A. The Compliance Gap

79. **To assess the compliance gap for financial statements prepared under IFRS and RAS, 29 sets of audited financial statements were reviewed,** six IFRS financial statements and 23 RAS financial statements. All financial statements selected were prepared as of the end of 2006. All companies preparing IFRS financial statements prepared them therefore in accordance with *full* IFRS as opposed to *endorsed* IFRS (see Para. 30). The sample included consolidated and individual financial statements for banks (5), insurance undertakings (4), and other companies of the non-financial sector (20). Due to the basis on which the sample was selected and its relatively small size, the outcome cannot be considered representative for all Romanian companies. Hence, the findings, although useful for indicating potential systemic problems in financial reporting, pertain only to shortcomings found in the financial statements of specific companies.

80. **Fewer than 20 per cent of the audit opinions in the sample were qualified.** The audit opinions on financial statements prepared under IFRS or RAS included 25 unqualified audit opinions of which five included an emphasis of matter paragraph drawing the attention of the reader to some specific aspects of the financial statements. Four audit reports were qualified. All audit opinions referred to the appropriate accounting framework, either RAS or IFRS, used for the preparation of the financial statements.

B. IFRS Compliance Gap for Enterprise Sector Companies

81. **For the enterprise sector, three sets of audited consolidated financial statements prepared under IFRS were reviewed.** While it is mandatory only from 2007 onwards for listed companies to prepare consolidated financial statements in line with the EU IAS Regulation (EU regulation 1606/2002), reviewed companies had prepared their consolidated financial statements under *full* IFRS for the year 2006.

82. **No significant non-compliance issues were identified during the review of the consolidated financial statements for companies of the enterprise sector.** All three companies selected were listed on the BVB and were subsidiaries of large international companies.

83. **None of the audit opinions was qualified.** One audit opinion included an emphasis of matter paragraph relating to uncertainties concerning legal proceedings against the company's executives.

C. IFRS Compliance Gap for Financial Sector Entities

84. **The review included three sets of financial statements prepared under *full* IFRS, comprising two sets of consolidated financial statements and one set of individual financial statements; all financial statements reviewed were for banks.** The individual financial statements were from a local bank, and were prepared under *full* IFRS on a voluntary basis as there are no requirements for banks to prepare IFRS individual financial statements in Romania. Two of the banks were foreign-owned subsidiaries of international banking groups and were required by their parent companies to provide IFRS financial statements. Banks were required to prepare consolidated financial statements in accordance with *full* IFRS for 2006 and are required to follow *endorsed* IFRS from 2007.

85. **The review did not identify any material instances of non-compliance with IFRS but only minor technical issues.** One of the banks had an emphasis of matter paragraph in the audit report relating to the use of internal methodologies for recognizing impairment provisions, limitations in segment reporting, and the use of the Euro as a secondary presentation currency.

86. **The operations of the banks reviewed were simple and did not include any complex financial instruments.** There are only few and simple derivatives operations undertaken in Romania: plain vanilla foreign exchange swaps and interest rate swaps. Predominantly, the banks under review had only retail and commercial banking operations.

87. **Compliance incentives in the banking sector are string because of enforcement by the banking supervisor and exposure to market discipline.** A qualified opinion prompts inquiries from the supervisor and banks' clients are very sensitive to compliance issues.

D. RAS compliance gap

88. **The sample comprised 23 sets of financial statements prepared under RAS including 22 sets of individual financial statements and one set of consolidated financial statements.** In general, financial statements included in the sample contained mandatory disclosures under RAS with minor compliance issues that did not affect significantly their presentation.

89. **Significant instances of non-compliance were reflected in** qualified audit opinions. The main non-compliance findings related to the following areas:

- Absence of recognition of some provisions
- Inappropriate impairment of non-current assets or investments
- Missing disclosures on commitments, related party transactions, and directors' remuneration
- Lack of prior year comparatives

90. **As noted in para. 70 above, Romanian companies tend to comply only with the minimum obligations explicitly required under RAS.** The additional disclosures needed to achieve high quality financial reporting and a "true and fair view" are often not provided. The absence of these comprehensive disclosures in the financial statements reviewed made it very difficult to identify instances of non-compliance with RAS simply by assessing the financial statements alone.

IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

91. **Some auditors in Romania, including member firms of international audit networks, used the emphasis of a matter paragraph in their audit reports in situations that arguably are not entirely consistent with the requirements of ISA 701.**¹² For example the following issues were referred to in emphasis of a matter paragraphs:

- Regulated fees by a state institution potentially causing an impairment issue for a company;
- Modification of accounting treatment due to changes in legislation, and
- Issues associated with unfavorable aging of trade receivables.

Auditors also used “emphasis of a matter” paragraphs to highlight an ambiguity under RAS or an interpretation of RAS that conflicted with IFRS. It is used as a practical way to deal with a situation in which specific Romanian legislation precludes accounting treatments otherwise required by the relevant accounting standards, e.g. prior year adjustments. The use of an emphasis of matter paragraph may be a reasonable and practical means of properly informing users of the financial statements, even though it may not be fully in line with a strict interpretation of ISA 701.

92. **In other instances, audit opinions issued by the auditors on financial statements prepared under RAS were not in accordance with ISA requirements:**

- One unqualified audit opinion included an explanatory paragraph stating that the auditors did not attend a year-end inventory count. While this paragraph preceded the opinion in the audit report, there was no reference in the audit report to any qualification.
- Another audit report contained an unqualified opinion despite the auditors stating in their report that certain non-current assets should have been impaired but the company failed to perform an impairment test.

93. **Instances of auditors preparing financial statements on behalf of their audit clients appear to be limited.** EGO 75/1999 requires that enterprise management provide the auditors with the financial statements prepared by the enterprise. While there is a perception that significant improvements have been achieved in this regard, instances still can be found in which auditors prepare financial statements on behalf of their clients. Smaller enterprises may lack financial reporting expertise and therefore expect the auditors to prepare their financial statements.

¹² ISA 701 *Modifications to the Independent Auditor's Report* requires auditors to consider including an emphasis of a matter paragraph in the unqualified audit opinion when:

- There is a significant uncertainty relating to the going concern of a company;
- There is a significant uncertainty (other than a going concern problem), the resolution of which is dependent upon future events and which may affect the financial statements. An uncertainty is a matter whose outcome depends on future actions or events not under the direct control of the entity but that may affect the financial statements; or
- There are matters other than those affecting the financial statements, for example, if an amendment to other information in a document containing audited financial statements is necessary and the entity refuses to make the amendment.

V. PERCEPTION OF THE QUALITY OF FINANCIAL REPORTING

94. **Reliance by lenders and investors on financial statements prepared under RAS still appears limited.** Despite the perceived progress in improving the quality of financial reporting, including aligning Romanian accounting and auditing laws with the *acquis communautaire* in the field of corporate financial reporting, investors still prefer having financial statements prepared under IFRS and audited by member firms of international audit networks. Further, when reviewing loan applications, banks still place little reliance on financial statements. Financial statements are used more as a confirmation of the review of business plans and other banking due diligence procedures.

95. **There is a general perception that corporate financial reporting satisfies tax reporting needs ahead of the needs of other users, including investors and creditors.** A recent survey published in the CAFR monthly publication concludes that there is a predominant influence of taxation during the preparation of financial statements. Often, enterprises do not prepare separate general purpose financial statements and financial statements for tax purposes. Therefore, tax rules would influence financial statement preparation. For example, local taxes on land and buildings drive the revaluation process in RAS financial statements: an increased tax rate applies when land and buildings are not revalued. In addition, notes to financial statements appear to be limited to minimum requirements. Companies do not always appear to understand that the objectives of accounting standards differ from tax requirements.

VI. POLICY RECOMMENDATIONS

96. **The recommendations of this accounting and auditing ROSC report are mutually supportive in some obvious ways.** For example, superb accounting standards are jeopardized at the outset if people do not understand how to translate the standards into a journal entry. Without attempting to provide a detailed tactical design for reform, and without pretending to do justice to the true specificity of the country's conditions, this report sketches out policy recommendations to enhance the quality of corporate financial reporting. As work on the economics of information – the role of information in a well-functioning economy – demonstrates, enhancing the reliability and availability of financial reporting is conducive to:

- strengthening Romania's financial architecture and reducing the risk of financial market crises and their associated negative economic impacts, including through increased transparency about the financial condition and performance of public-interest entities;
- contributing to foreign direct and portfolio investment;
- helping mobilize domestic savings;
- facilitating investment decision-making by private pension fund managers;
- facilitating the access of smaller-scale corporate borrowers, including small and medium-sized enterprises, to credit from the formal financial sector by shifting gradually from collateral-based lending decisions to lending decisions based on the financial performance of the prospective borrower;
- improving the assessment and collection of taxes on corporate profits;
- allowing investors to evaluate corporate prospects and make informed investment and voting decisions, resulting in a lower cost of capital and a better allocation of resources;
- allowing shareholders and the public at large to assess management performance, thus influencing its behavior (financial reporting is also a building block of a market-based monitoring of companies); and

- assisting the authorities to monitor and enforce compliance with the relevant portions of the *acquis communautaire*.

97. **Statutory Framework:**

- **The recently-adopted Audit Regulation should be rapidly implemented and the newly established public oversight body should commence its operations.** While some elements of the amended Eighth Company Law Directive are already implemented by the CAFR the new Public Oversight System, still needs to be made operational. The amended Eighth Company Law Directive deals with all aspects of the audit profession and the implementation of a variety of processes will be challenging as the directive requires high quality standards in all the following processes: approval of auditors and audit firms; continuing education and mutual recognition; professional ethics, independence, objectivity and professional secrecy; auditing standards and audit reporting; quality assurance; investigations and penalties; public oversight and regulatory arrangements between Member States; appointment and dismissal of the statutory auditor; special provisions for the statutory audit of public-interest entities; and international aspects. All these aspects need to be monitored by the Public Oversight System, which bears the ultimate responsibility for all these processes. The development of the institutional and human capacity required to discharge these new responsibilities successfully will pose substantial challenges.
- **The accounting law should require that public-interest entities defined in the law, including listed companies without subsidiaries and private pension funds, prepare endorsed IFRS individual financial statements.** Public-interest entities without subsidiaries should be required to prepare individual financial statements using *endorsed IFRS* (in addition to RAS for the purpose of reporting to the MEF) to ensure transparency and comparability with other entities preparing consolidated financial statements under *endorsed IFRS*. Listed entities without subsidiaries are not required to prepare IFRS financial statements under the current Law or the EU regulation 1606/2002 on the application of IFRS. Private pension funds that will carry the assets and liabilities of the new private pension system should also prepare IFRS financial statements.
- **The creation of a more inclusive standard setting process should be considered.** The standard setting system could be expanded to provide for broader consultation with preparers, users and auditors. While public interest entities will be required to move to *endorsed IFRS*, the standards setting system for non public interest entities should include, beyond the supervisory authorities and the accounting profession, preparers and users of financial statements.
- **The MEF should expand the scope and level of detail of RAS for large companies, and could consider reintroducing an IFRS fall back position under RAS.** RAS requirements, although sufficient for smaller enterprises, do not satisfy the needs of users of large companies' financial statements, including banks and investors. While IFRS are too complex to be used by small and medium-sized enterprises, the MEF should provide authoritative guidance for applying RAS, in particular with respect to disclosure.

98. **The Profession**

- **A review of CAFR and CECCAR's current governance principles and arrangements should be conducted by an independent reviewer.** This should include a review of related-party transactions, the leadership nomination process and the length and concentration of power and authority. The report of the independent reviewer should be subsequently published together with a plan for implementation of the report's recommendations.

- **The range of activities of CAFR and CECCAR should be publicly clarified.** While the law is explicit in reserving the external audit function to financial auditors, it should further be clarified that CECCAR members acting as censors are not carrying out audits.
- **CAFR should not regulate internal auditors.** While it may have been important to provide the Romanian chapter of IIA with initial standards and requirements, the Romanian IIA has been a full member of IIA since 2003. Further, the requirement for having a financial auditor as head of the internal audit department could be amended and Certified Internal Auditors could be also appointed to head the internal audit department.

99. **Monitoring and Enforcement**

- **CAFR should enhance the capacity of its monitoring unit and the scope of the review of individual audit files.** While the monitoring unit appears to have received proper education and training, its members do not always have professional experience as auditors. The lack of practical auditing experience might limit the ability of the monitoring team's members to review audit files effectively, particularly in the case of audit files of banks or insurance undertakings. One possibility would be to include in review teams, when carrying out monitoring reviews, a financial auditor with experience in these fields. In addition, the scope of the review should be enhanced significantly to ensure a proper review of audit files.
- **CNVM and CSA should ensure effective supervision over general purpose financial statements of listed companies and insurance undertakings respectively.** In addition, CNVM and CSA should each publish annually a report on the results of their monitoring of general purpose financial statements. No evidence of enforcement relating to financial statements has been found in the last two years in either CNVM or CSA annual reports.

100. **Education and Training**

- **CECCAR, CAFR and the universities should coordinate to improve the quality of professional education and agree on a strategy for converging the two professional education systems.** To improve these education requirements, CECCAR and CAFR, under the supervision of the Ministry of Education and the MEF, should create, together with representatives of the universities, a commission to review the quality of the courses and trainers for professional education. The commission should be given a mandate to achieve consistency between the two curricula and ease the ability of future members of one body to become members of the other. The commission should consider the importance of financial auditors' professional qualification; the exams for an expert accountant to become an auditor should reflect this importance.
- **Taking as an example the Academy of Economic Studies of Bucharest, other universities should enhance their accounting and auditing curricula and seek for their graduates exemptions from examination by international accounting qualification providers.** Considering the lack of qualified accountants in Romania and in order to develop the accounting and auditing profession, universities should follow the successful example of the Academy of Economic Studies of Bucharest in implementing an enhanced curriculum for accounting and auditing. Graduates of the Academy of Economic Studies of Bucharest will be awarded by ACCA several exemptions from examinations required to complete the ACCA qualification. Such initiatives promote the accounting and auditing profession, and provide incentives to students for whom it may shorten the professional qualification cycle.