



## ASPECTS REGARDING THE EVOLUTION OF THE PROFIT AND LOSS STATEMENT IN ROMANIA

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### Abstract

*The present paper presents the evolution of the profit and loss statement along with the accounting evolution in Romania under different aspects, mainly under the structure, content and the format of this financial statement. To group general ideas regarding the evolution of the profit and loss statement, we have divided the work into two parts: aspects related to the profit and loss statement until the year 1989 and, respectively, after 1989. Therefore we have drawn several observations regarding to this annual account in each phase of Romanian accounting reform, thus outlining its evolution in time.*

**Keywords:** profit and loss statement, the phases of accounting reforms from Romania, accounting regulation, accounting system, Romania

**JEL Classification:**

### I. Introduction

In this paper we propose to analyze the profit and loss statement along with the accounting evolution in Romania. What today is called the Profit and loss statement is a financial statement which together with the other financial statements, is prepared in order to provide information about the financial position and the financial performance and cash

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flows of an entity, which are useful to a wide range of users in economic decisions making, according to the International Financial Reporting Standards.

But the question raised about this topic is concerning the level of suitability of the structure, content and format of this financial statement developed nowadays as ideal to serve the objectives in terms of which it was built, being given its use especially in the development and presentation of metrics that reflect performance of an enterprise. In this context we align with the opinion of Professor Bernard Colasse according to whom, the profit and loss statement is not suitable for the same analytical and decision uses (depending on the manner of the classification of expenditure and revenues), "its format makes it by default dedicated for certain interested stakeholder category, more than another, this being somehow a utilizing way" (Colasse, 2009).

Due to the fact that we consider that in order to understand any present, it has to be analyzed and compared with its past, the present paper proposes a brief overview of the evolution of this financial statement for a better view, under various common aspects, in parallel with the history of accounting and accounting reforms from Romania.

Therefore, we try to find answers to some research questions: What are the origins of profit and loss statement? When has this statement appeared and for what purpose? What changes have been made over the years? To what extent these changes serve the interests of decision makers today?

To group general ideas regarding the evolution of the profit and loss statement, we have divided the work into two parts: aspects related to the profit and loss statement until the year 1989 and, respectively, after 1989.

## **II. Aspects regarding to the profit and loss statement until the year of 1989**

Although "the stage of forming Romanian accounting literature" (Ionaşcu, 1997), as Professor Ionaşcu states in his paper, starts in 1837 "with the advent of appearance of the first accounting works in Romanian language" and ends in 1900, however, we consider the year 1929, an important start in the evolution of the profit and loss statement, when through the Public Accounting Law, the double-entry principle in the general accounting of the state was introduced, as Professor C G Demetrescu proved (Demetrescu, 1972). Starting with this year, the companies operating and managing of the state properties, as well as the autonomous administrations were mandated to prepare "Profit and Loss"



statement, based on an imposed layout drafted by the Superior Board of enterprises and public goods management in that period.

It is remarkable that starting with the year 1929, the concept of profit and loss statement has been used and an imposed layout draft was pre-established for being used by the state enterprises and autonomous administration, as well.

***The period between 1900-1950 was an important step in the development of Romanian accounting culture and practice*** according to the evidences of several authors (Demetrescu, 1972, Ionașcu, 1997, Neag, 2000, Albu N.C, Albu N. and Alexander D., 2011), during which, the doctrine sought to answer the scientific substantiation of accounting, when different streams of thinking emerged, taking inspiration of Italian, French and German origins. But unfortunately this wave of accounting maturation was overthrown once in Romania the communist regime was installed. The new accounting guidance normalization and hence the synthesis accounting statements (the balance sheet and the profit and loss statements) proposed by Spiridon Iacobescu, the leader of the patrimonialist current and by Ion Evian, the economic current representative, as well, have not been materialized yet (Ionașcu, 1997).

***The period between 1950-1989 is marked by the ideology of communism.*** The Romania's economy becomes a planned and centralized economy, being under Soviet influence. The primary and the only user of accounting information becomes the state.

We can describe this period of the Romanian accounting system, especially with regard to the profit and loss statement, better the words chosen the mastery professors N.Feleață and Ion Ionașcu (1998), within the following paragraph:

*"..The accounting terms within the patrimony field lose their usances and interest. Paradoxically, the efficiency and profitability concepts become common place. An economy that became more and more bankrupted was creating its "performance indicators" but which had no economic support. Theoretically, being oriented to flows, the Romanian accounting (?) should have set as priority the profit and loss statement. This account did not even exist, unless we do consider a part of the "execution of revenue and expenses budget" as such an account. Yet, the current accounting abounded in information of "incomes," "expenses" and "results" type".*

Under a political regime that lasted for so many years, the Romanian accounting culture has undergone profound changes, "in summary, under this system, financial accounting statements solely served the purpose of reporting the Fulfillment (or the over-Fulfillment) of the plan" (Albu and all., 2011).



### **III. Aspects concerning to the profit and loss statement from 1989 up to date**

The change of the political regime in Romania starting with 1990 (since the communist regime fell in December 1989) and, simultaneously with this, the transition period from a planned, centralized economy to a market economy, has triggered the necessity of Romanian accounting system reform.

The Romanian accounting reform steps have been thoroughly discussed over the years by several authors (e.g. Ionașcu and all, Albu and all, 2011, Neag, 2008), therefore, we try to present few minimal aspects regarding the profit and loss statement, which were "drawn" by every step of the accounting reform.

*The first phase of the accounting reform is considered to be the period of 1991-1999.* Being during transition period, Romania adopted the continental accounting system. Considering the fact that Romania's perspective was joining the European Union, after 1990, the purpose of the legislature was transforming the Romanian accounting practices to become compatible with the ones internationally applied, especially to European ones. In this context, "from information prepared only for macroeconomic statistics, the accounting information within the new system is addressed to different categories of users (even though the state still remained the preferential user of accounting information)" (Neag, 2000, pp. 210).

The first law regulating the Romanian accounting at that time was the Accounting Law no.82/1991, which was implemented by adopting the Government Decision no. 704/1993. Therefore the Romanian economic entities began to operate under this law only since 1994. In the chapter 5 of this Government Decision, the Romanian normalizing institution defined the "accounting balance sheet" (ro. Bilant contabil) as consisting of "balance sheet, profit and loss account, respectively the execution account, in case of public institutions, the annex and the management report."

Being inspired from French model, "even the formats of the financial statement (balance sheet, profit and loss account) were much closer to the French ones" (Neag, 2008).

Few aspects with regard to this annual account can be observed: it was an annual or quarterly statement, which along with the balance sheet made up the so-called "accounting balance sheet"; there was a standardized format, the presentation nature of its structures which formed it was a list type, where the expenses and the incomes were



classified according to their nature in expenses, respectively operating, financial and exceptional incomes. Thus at the end of the account, the Net Result of the financial year was determined as Total Incomes - Total Expenses (Figure 1).

The expenses and, respectively, the exceptional revenues were defined as not being related to the normal activity, the current one of the patrimony unit; in this way, the net result was generated by the current and exceptional operations of the company.

Moreover, this annual account preparation was hampered by few significant drawbacks: there were not any criteria for recognition of the elements that compose the financial statements; the rules for determining the result were not clear, and the definition of accounting principles were not clearly defined. Although there was a basic system and a simplified one dedicated for financial statements, the difference between them was minimal and retrieved in annexes, therefore the small and medium-sized enterprises were preparing the same annual account as the big ones.

**Figure 1 - The profit and loss and account**

1.	Operating incomes
2.	Operating expenses
3.	The Operating result (1-2)
	Profit
	Loss
4.	Financial incomes
5.	Financial expenses
6.	The Financial result (4-5)
	Profit
	Loss
7.	The current result (3+6)
	Profit
	Loss
8.	Exceptional incomes
9.	Exceptional expenses
10.	The exceptional result (1+4-2-5)
	Profit
	Loss
11.	Income tax
12.	The result of the financial year (1+4+8-2-5-9-11)
	Profit
	Loss

Schema issued according to GD no. 704/ 1993



**The second stage of the Romanian accounting reform is considered the period of 1999-2005**, as the Order no. 403/1999 developed by the Ministry of Finance which contained accounting regulations harmonized with the fourth European Directive and International Accounting Standards "marks a turning point in the development of accounting system in Romania" (Neag, 2000) and the related purpose was the implementation of IAS for large enterprises. Further, it was taken over and improved by the Order no. 94/2001 for the approval of the accounting regulations harmonized with the Fourth European Directive and the International Accounting Standards, which contained "several volumes with the following elements: a chart of accounts (the Franch-based one with some modifications), principles of Anglo-Saxon origins such as substance over form and materiality, IASC-s conceptual framework, definitions and accounting policies as taken from IAS, the translation of IAS" (Albu, Albu, Bunea, and all., 2011). The order was applicable for both the listed companies and the companies that meet other criteria defined by law, as well, and for companies that do not meet these criteria, another order has been issued: OMFP 306/2002 which approved simplified accounting regulations, harmonized with the European Directives.

During this period some of the changes to the profit and loss statement were:

- criteria of recognition and measurement of revenues and expenses were defined;
- the term of " accounting balance sheet" is changed to the "annual financial statements" of the enterprise comprising of the balance sheet, the profit and loss statement, the statement of the changes in equity, the cash flow statement, the accounting policies and explanatory notes;
- the profit and loss account format was mandatory to be list type, by adopting the structure of classification of the expenses and incomes by nature, into operating, financial and extraordinary expenses, respectively incomes, format taken from the Fourth European Directive of the EEC;
- the exceptional activity is observed to be substituted by the extraordinary one and it is defined by the Order no. 94/2001 as "events or transactions other than the current activities of the company and which are not frequently or regularly";
- all the companies, regardless of their size had to prepare such an annual account, noting that the Order no.94/2001 stipulated in addition to the last item of the profit and loss statement, the result per share, basic or diluted.



This profit and loss statement model facilitates the information needs of the state, since it provides the support based on which the value added as a matter of a macroeconomic indicator is calculated.

It can be observed that although the orientation of the second stage of the Romanian accounting reform was towards both Fourth European Directive of the EEC and to the International Accounting Standards, and that one of the reasons for the change, was that the accounting system created following the French model, in the first stage of the reform, was not suitable to satisfy the information needs of investors from abroad, considering the context of the capital market development aim, however the format of the profit and loss statement did not take over the Anglo-Saxon model, in which the incomes and expenses are presented according to their allocation. As a relevant proof is the close connection between the public power and the accounting normalization. Even though this model facilitates the calculation of the intermediate management balances, it is still strongly oriented towards state information need than to the need of other users in making economic decisions.

Even *in the third stage of the reform, started in 2005 until now*, this format has not changed. Through the regulations imposed by the Order no.1752/2005 (through which the Order no. 94/2001 and Order no.306/2002 were abrogated) for approval of accounting regulations compliant with European accounting Directives, the profit and loss statement also had the same mandatory format for all the entities, small and medium-sized or large, listed or unlisted, taken from the Fourth European Directive of the EEC. However it is remarkable that both the Order no.94/2001 and the Order No.1752/2005 provided a split of the operating expenses based on allocation criteria described in Note 4 "The analysis of operational result."

This sudden change in accounting rules was somehow unexpected, given that all the companies had to prepare financial statements in conformity with European Directives, including those that have adopted IFRS in the previous step.

But starting with 2006 up to present, the accounting reform has been continued by developing a strategy for implementation of IFRS. A new order no.1121/2006 has been issued; it states through the Article 1 that in Romania, the gradual implementation of International Financial Reporting Standards (IFRS) as requirement to ensure the compliance of the national accounting regulations with EU regulations is being continued.

Therefore, within the financial exercise of the year 2007, the listed entities on a regulated market were mandatory required to prepare consolidated financial statements



according IFRS. Also, since 2012, IFRS became mandatory for financing statements of banking institutions, but also for individual financial statements of the listed entities. The extent of applicability of IFRS within the Romanian environment is growing, according to the national strategy. In this context, the entities authorized, regulated and supervised by CNVM had to prepare as well, a second set of annual financial statements in accordance with the International Financial Reporting Standards, according to Order CNVM 116/2011 for the years 2011 and 2012, for information purpose.

In 2009, the Ministry of Finance issued the Order no.3055/2009 for approval of the accounting regulations compliant with European directives, through which the Order No.1752/2005 was abrogated. Although this order has brought improvements to both the content and structure of the profit and loss statement and it is more open to financial analysis, however, the Romanian standard does not retract the approach by nature of the expenses and incomes, since this is the only approach through which it exercise the fiscal control function. The format is kept the same.

#### **IV. Conclusion**

The profit and loss statement is currently the main financial statement based on which the enterprise performance measurement indicators are determined.

As described above, during its history, the profit and loss statement has various meanings, yet since 1929, when after the introduction of the double-entry accounting principle in the general accounting of the state, a standardized template for a related scheme has been established by law for the state enterprises and autonomous administrations.

Although guidelines for normalization of this financial statement have been existed since 1941, under the influence of the public bodies, they have not materialized (Ionaşcu, 1997) as in the next four decades, the Romanian accounting, from 1950 to 1989, was marked by radical changes due to the influence of the ideology of the political regime established. During this period, despite the fact that the terms "incomes," "expenses" and "results" were used, the profit and loss statement "did not even exist, unless a part of the "execution of revenue and expenses" is considered as such an account" (Feleagă and Ionaşcu, 1998).

Since 1990, the profit and loss statement has reappeared in the Romanian accounting normalization, being a replica of the French model. Initially, in the first stage of the Romanian accounting reform, the profit and loss statement was part of the



"accounting balance sheet", then, in the second stage of the reform, it became "financial statement", when the general orientation was towards a mixed accounting system, influenced by both European and international requirements.

In the first stage, the profit and loss statement has represented a takeover of the French results account, which through its format, structure and content was more oriented towards meeting of the information needs of the state. Considering the fact that Romania was at the beginning of a process of change, that there was a transition period from a centralized economy to a market one, that the Bucharest Stock Exchange was reopened only at the end of 1995, the need for financial information, inclusively on enterprise performance was significantly reduced compared to the present one.

Although in the second phase of accounting reform, the directions of the accounting system were oriented to both European and international requirements, that the need of financial information increased, that the foreign investments were intended to be attracted, however, the Romanian normalizing institution adopted the same format of the profit and loss statement of list type, by classification of the incomes and expenditures by their nature. However, this model is amended by a classification based on the purpose of operating expenses in the Note 4 "Analysis of operational results", proceeding therefore to a double representation of revenues and operating expenses.

Even in the last stage of reform, the Romanian normalizing institution does not retract this regulation of profit and loss statement, although its content has been improved.

Thus, it can be concluded that although the profit and loss statement has gone through many changes over the years, that at each stage of the Romanian accounting reform it has been improved, being now much more open to financial analysis, however, this financial statement was and remains regulated by the public power, through its institutions. Therefore, although the literature has proposed other models of profit and loss statement (Bătrâncea L.M and all., 2012) and, the utility of Anglo-Saxon model was internationally recognized as providing better information to managers in decision-making, yet the state remains the main actor in Romanian accounting normalization, so this financial statement remains under fiscal control desire to fulfill its function, being strongly oriented to the state information need rather than to need of other users for applying it in making the economic decisions.

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