EXISTING LOCAL GOVERNMENT ACCOUNTING STANDARDS AND PRACTICES IN ROMANIA

Prepared for

East European Regional Housing Sector Assistance Project
Project 180-0034
U.S. Agency for International Development, ENI/EEUD/UDH
Contract No. EPE-C-00-95-001100-00, RFS No. 804

Prepared by

Mark Abrahams

THE URBAN INSTITUTE
2100 M Street, NW
Washington, DC 20037
(202) 833-7200
www.urban.org

May 1997
UI Project 06610-804

TABLE OF CONTENTS

EXECUTIVE SUMMARY

The objectives of this paper are to describe and analyze existing local government accounting standards and practices as the basis for interpreting municipal (cities and villages), judet (county) and regii (utility) budgets and financial statements and for assessing the accuracy and reliability of those documents. Local governments include approximately 41 counties, 60 cities and between 5,000 and 6,000 villages. This paper is based on a review of the laws and regulations that determine existing standards at a national level. The accounting treatment of depreciation as compared with proper depreciation, and the tax treatment of municipal revenues and regia revenues were also reviewed. The laws or regulations reviewed were:

- Law 945, 1990 Depreciation Adjustment
- Law 10, 1991 Finance Law, revised as Law 72 in 1996
- Law 26, 1992 Inflation Adjustment
- Law 15, 1994 Depreciation of Fixed Assets
- Ordinance 70, 1994 Inflation Index Provisions, as revised by law 73/1996
- Law 27, 1994 Local Taxes and Fees
- Decree 500, 1994 Revaluation of Fixed Assets
- Depreciation Decrees 1995 and 1996
- Law 23, 1996 Regia Distribution of Profits Regulations

This paper is also based on a site visit to the city and county of Targoviste and the respective county regia (roads and bridges) and the respective city regia (performing seven activities), to observe their accounting practices, including depreciation. Inflation and depreciation accounting practices were reviewed in more depth at the Vulturul Sa Busau Beer Brewery.

The report includes accounting recommendations as well as recommendations on legal and regulatory reforms and other measures required to bring current municipal accounting standards and practices into conformity with recognized international standards and to enhance the prospects for establishing a successful municipal credit finance system in Romania.

EXISTING LOCAL GOVERNMENT ACCOUNTING STANDARDS AND PRACTICES IN ROMANIA

SUMMARY OF FINDINGS AND RECOMMENDATIONS

- The accounting practices for the local governments in Romania are governed by law. There has been no attempt to conform these local government accounting practices to International Accounting Standards (IAS) nor generally accepted accounting principles (GAAP). Such standards are generally promulgated by an external third party such as the Financial or Governmental Accounting Standards Board. The application of international accounting standards to Romanian businesses is currently under review by the British Know How Fund. This group should be encouraged to consider the implications of trying to apply these standards to local governments in Romania. Also, there is an independent Romanian association, CECAR, which is lobbying to be both the association and the standards setting body. It might be useful to include this organization in the review.

- The balance sheet for municipalities and judets and the balance sheet and the income statement for the regii constitute the financial statements, which are supplemented by Annex reports. These statements are organized to demonstrate compliance with law. They are not intended to, nor do they, comply with international accounting standards nor generally accepted accounting principles. The following are some examples of the departure from these standards in the financial statements as currently presented:

  — Municipal and Judet governments do not depreciate fixed assets, and do not record accounts receivable or bad debt expense. They maintain their records substantially on the basis of cash accounting. Expenses incurred and not paid are recorded as an accounts payable at year end.

  — Regii financial statements have been adjusted for inflation in accordance with IAS 29 through June 30, 1994. Financial statements prepared for December 31, 1995 and 1996 are not consistent with IAS 29 and do not present fairly the financial position of the regii, particularly in an economy that has been characterized by hyperinflation. This will become an important issue in a municipal credit finance system. Also, regii financial statements do not include a statement of cash flows.

  — Regii financial statements include fixed assets utilization adjustments which result in lower depreciation expense, higher net income, and higher income tax payments. This practice does not appear to be consistent with international accounting standards and appears to follow profit reporting practices for state owned businesses. More research is needed. The practice of reporting more profitable state owned enterprises should be further reviewed and reconsidered as the country proceeds with privatization.

  — With these exceptions, the financial statements prepared by local governments and by the regii represent the true financial position and results of operations.

NEXT STEPS

There are several follow-up steps to consider:

General

- Romanian local government depreciation accounting is integrated with inflation accounting and utilization methodologies. While the legal and theoretical practices are documented in this paper, additional work is needed to validate the inflation, depreciation and utilization concepts as practiced to determine whether the use of utilization coefficients should be continued and to determine the extent to which fixed assets and accumulated.

- Inflation accounting guidance provided by the Ministry of Finance ceased as of June 30, 1994. There is concern at the Ministry of Finance that additional guidance may fuel additional inflation. The theory is that inflating depreciation expense as a result of inflation accounting may in and of itself add to the inflationary spiral. Nonetheless, there is a need to bring the financial statements prepared after June 30, 1994 into a fair presentation of the financial condition within the context of an economy that has experienced hyperinflation in recent years. Additional work with the Ministry of Finance should focus on: (1) how to address the issues affecting financial statements for fiscal years 1995 and 1996 in the context of IAS 29 inflation guidance; and (2) understanding better how depreciation impacts inflation in Romania.

Local Governments

- Additional guidance can be provided to clean up the financial statements of local governments relative to accounts receivable and bad debt expense provisions. There are no accounts receivable nor bad debt expense established on the balance sheet and Annex reports for a municipality or county during the year or at year end. Thus the balance sheet does not present the full financial position of the municipality or county. Accounts receivable can be established with revenue deferrals and allowances for uncollectible accounts on the balance sheet. Subsidiary accounts exist for both individuals and businesses which document the original amount owed, amounts paid and the balance owed. While the bad debt expense can be recorded in the detailed accounting records, it is not presented on the income statement and is not considered as an offset to the accounts receivables account.

- Romanian local governments should include accounts receivables on the balance sheet and bad debt expense on the income statement. Bad debt expense should be recorded and offset the accounts receivable and may be presented as a gross amount or netted with the accounts receivable. This suggestion is consistent with fair presentation of the financial position of the government and could also increase control over the receivables.

Regii

- Ordinance 70/1994 was issued to provide large tax payers with tax relief. This was required by the policy of using fixed asset utilization coefficients which in effect resulted in higher profits and higher income tax payments. Ordinance 70 is applicable to regii with revenues in excess of 10 billion lei which employ more than 299 employees. Additional follow-up to identify and visit regii which meet these thresholds is needed.

- It would be useful to consider adding cash flow statements to the existing financial statement formats used by the *regii*. This is especially important given the growth in accounts receivable and accounts payable of these organizations.

REPORT FORMAT

This paper discusses Romanian local government:

— Uniform standards
— Financial statements
— Basis of accounting
— Budgeting
— Fixed assets and depreciation accounting
— Inflation accounting
— Issues and Recommendations

UNIFORM STANDARDS

The standards for local governmental accounting in Romania is found in Romanian law and regulations applicable to public institutions. There are no formal international standards nor generally accepted accounting principles that are followed beyond compliance with applicable law and regulations.

European Directive No. 4

Romania is moving toward compliance with European Community accounting standards, rather than other international standards. This means that questions about compliance with IAS relate to the applicability of European Directive No. 4 to the accounting standards of Romania.

The Fourth Directive was drafted over a period of 10 years and was initially approved in 1978. It is the European Directive relating to financial reporting. The Fourth Directive provides guidance for the content and presentation of annual financial accounts and reports, the valuation methods used, and the publication rules. It aims to ensure that annual reporting discloses comparable and consistent information. The Fourth Directive provides detailed formats for reporting balance sheets and income statements.

Whenever this report refers to international accounting standards, the reader should take that as meaning European Directive #4, with one exception. That Directive does not deal with inflation accounting issues. In that case, the report references applicable international accounting standards by name, such IAS 29.

History

Romanian accounting, in its present form, dates to the mid-1940s, when the centrally planned economy was first implemented. In 1948 all private enterprises were nationalized. Shortly thereafter, around 1950, the first classification of accounts was established. Up to and through 1990, minor changes were made to these accounting standards. Romanian accounting reflected true plant or cost accounting where the concepts of cost and financial accounting were combined into one accounting system. From pure accounting theory, this accounting system provided direct and indirect costing. It also adhered to the concept of using a separate class of accounts to determine the cost of goods manufactured and finished goods, including direct and indirect costs.

Between the 1990 and 1994, the Romanian government began to modify the accounting standards to develop the current model which consists of three major elements of account classifications: (1) operations; (2) financing; and (3) extraordinary. There have been many other changes to the accounting system, including commercial and tax accounting methods. The VAT was introduced. Salary and income tax accounting were modified to reflect the shift from the entity to the employee for the payment of these taxes. The concept of notes receivable and payable was also introduced. Nonetheless the country retained the pre-1990 chart of accounts during this period.

Commencing January 1, 1994, Romania implemented a new chart of accounts through a regulation issued by the Ministry of Finance. The new classification structure includes the valuation of fixed assets, depreciation accounting, accounting for bad debts, national currency devaluation, and other changes consistent with the European Directive #4.

The 1994 model focuses on financial accounting with an emphasis on tax accounting and little to no emphasis on cost accounting. These changes apply to business and regia accounting systems. While the accounting system allows for provisions for bad debts, bad debt expenses may not be deducted in determining taxable income. This may be a reason why bad debt provisions are rarely present in regia accounting. The same may be true for other accounts such as protocol, marketing, sponsorships, and other extraordinary expense accounts that also do not affect taxable income.

British Know How Fund

In general, the 1994 accounting classification structure is in accordance with the Fourth European Directive as it applies to business and regia accounting. Starting in late February, 1997, the British Know How Fund began an estimated three year project to look further at the application of international standards as reflected in European Directives to Romanian business accounting. A team of 15 people, five from the Ministry of Finance, five from CECAR (an association of accounting professionals), and five academics, are looking at Romanian business accounting standards. However, local authority accounting, as applied to counties, municipalities and villages, remains unchanged and is not consistent with the Fourth Directive. While the focus of the Know How Fund's project is primarily on business accounting, it would be useful to encourage this project to look at the application of international standards as reflected in European Directive #4 to government standards as well.

FINANCIAL STATEMENTS

General

All financial statements for the municipality, county or regia are based on a calendar year (January 1 through December 31) fiscal year. Each municipality, county and regia prepares a separate balance sheet supported by several Annex reports. The regia also prepares a profit and loss statement.

Regii

The regia prepares one balance sheet and one profit and loss statement which are supported by several "Annex" reports which are an integral part of the financial statements. Thus there are two formal statements with supporting detail. The Annex includes:

Annex 1	Profit Distribution
Annex 2	Stocks and Production in Course
Annex 3	Debts
Annex 4	Other Provisions
Annex 5a	Informative Data
Annex 5b	Establishment and Use of Reserves and Development Fund
Annex 5c	Taxes and Fees Paid and Owed
Annex 5d	Hard Currency Payments and Collections
Annex 6	Balance of Tangible, Intangible and Financial Assets
Annex 7	Other Information Regarding the Accounting Rules and Methods and Complementary Data

The Regia Balance Sheet

The regia balance sheet consists of assets and liabilities for the balance at the beginning and end of the accounting period or calendar year. It is expressed in thousand lei. The regia balance sheet is structured in outline form as presented in Attachment A.

The Regia Income Statement

The regia income statement presents a profit and loss for the current fiscal year and the two preceding fiscal years. It is also expressed in thousand Lei. The regia income statement is organized by profit or loss sections for the core activity (operations), financial activity, extraordinary revenues and costs, and gross and net profit or loss. The regia income statement is structures in outline form as presented in Attachment B.

Municipalities/Counties

General

The municipality and county (judet) each prepare one financial statement, the balance sheet. The balance sheet is supported by several Annex reports, which are an integral part of the financial statement, the most important of which are the Account of Execution of Revenues and Expenditures (Annex 12), and the Detail of Expenditures (Annex 14). The Annex includes:

Annex 10	The Execution Account of the Public Institution's Balance
Annex 12	Account of Execution of Revenues and Expenditures
Annex 14	Detail of Expenditures
Annex 15	Available Out of Special Purpose Funds
Annex 16	Budgetary Financing - The Annual Loose Sheet
Annex 17	The Funding of Investments
Annex 18	Unpaid Debts at the End of Trimester

In addition, there are two other schedules: the Analytical Report Based on the Balance Sheet and the Calculus and Substantiation Indexes (Relative to the Structure of the Budget) n an Annual Basis.

The Municipal/County Balance Sheet

The municipal/county balance sheet consist of assets and liabilities for the balance at the beginning and end of the accounting period or calendar year. It is expressed in thousand lei. The municipal/county balance sheet is structured in outline form as presented in Attachment C.

BASIS OF ACCOUNTING

Regii

The regia maintains its accounting system on a full accrual basis. This includes depreciation of its fixed assets. However, the depreciation and valuation of fixed assets may be different from generally accepted accounting principles due to the high inflation rate the country is experiencing. This treatment will be discussed later in this paper.

Municipalities/Counties

Municipalities/counties maintain their accounting system on a cash basis for both revenues and expenditures. The is evident in the Annex Reports 12 and 14 where the term "expenditures" are utilized and not the term "expense." There are no accounts receivable and bad debt expense established during the year nor at year end. There are however expense accruals for liabilities owed as of December 31 (i.e., payroll payable).

BUDGETS

General

Local governments in Romania are empowered to develop, adopt and administer annual budgets. Budgets are developed in public sessions and must be approved by a majority of the local counsel. If a budget cannot be approved by the start of the new fiscal year (January 1), local governments will be financed based on the prior year's adopted budget. The municipality or county can spend 1/12th of last years' approved budget each month until the final budget is approved.

The budget is essentially a line-item budget. The budget is prepared beginning in May preceding the beginning of the calendar year. The final budget is approved after the notification by the state of any transfers it will make. The municipality or county council approves their respective regia budget, including municipality or county investments and subsidies to the regia.

Municipalities/Counties

The budget is singular (one budget) for all revenues and expenditures. The current (CY1997) budget consists of CY1995 actual, CY1996 as budgeted (approved) and CY1997 as planned. There is a specified category of revenues based on the budget law. However, each municipality or county has its own revenue sources within the allowed categories. The revenue structure is summarized below and presented in more detail in Attachment D.

— Current revenues
  Direct taxes
  Indirect taxes
— Revenues from capital
— Shared revenues from state budget
— Subsidies from state budget
— Donations
— Loans

Local Revenues

Local revenues consist of local taxes and fees which are authorized and limited by law. Local governments are empowered to collect and spend tax revenues to meet local expenditures. However, local governments have limited ability to generate new or more sources of local revenues. Local revenues include taxes on:

— Buildings
— Land used for buildings
— Private transport
— Use of public places
— Notary services
— Publicity
— Resorts
— Museums
— Other

Local taxes are assessed and collected by the local Ministry of Finance office.

State Revenues

State annual budget laws provide state finances and allocate shared salary taxes to local governments. The salary tax is collected nationally and a certain percentage is allocated to the counties which in turn allocate the revenue to municipalities.

In addition to the shared revenues from the state budget, the state provides transfers to municipalities, villages and counties. There are basically two state transfers:

— Direct investment payments
— Social protection subsidies

Local governments are responsible for the construction and repair of local public works within their jurisdictions. Local authorities (or regii) will request state investment financing as part of the budget process for capital improvements. Local governments (or regii) also receive subsidies for the financing of social and municipal services and social protection actions for such operations as heating and transportation. These requests are submitted to the local Ministry of Finance office by the local government for review and approval. Once approved by the local MOF office, these requests are adopted by the local council and transmitted to the county for inclusion in the investment and subsidy annexes to the budget.

The state transfers are not determined until the state budget is finalized sometime in May or June. Thus municipality and county budgets are not finalized until after the state has notified the municipality and county of state transfers.

Many state receipts are received late, some as late as December. Any unspent state transfer receipts as of December 31 must be returned to the state and the process starts over again. This is true even if there is a contract to complete an investment project that continues beyond December 31.

Municipal/County Expenditures

In accordance with the budget law, the expenditure budget is organized by chapters and line-items within chapters. Like revenues, the municipal and county expenditure budgets have their own expenditure chapter and line-items in accordance with the budget law. A listing of the municipal and county expenditure chapters follow:

— Public Authorities
— Education
— Health
— Culture, Religion, Sports and Youth
— Social Assistance, Allowances, Pensions, other Assistance and premia
— Center Receiving Minors (orphans)
— Services, Public Development, and Housing
— Environment and Water
— Industry
— Agriculture and Forestry
— Transport and Communication Systems
— Other Economic Activities
— Scientific Research
— Other Activities (Military, Fire, Local Elections)

The expenditure line-items are summarized below and are detailed on Attachment E:

A. Running (Operating) Expenditures
   I. Personal
   II. Materials and services
   III. Subsidies

IV. Premia
V. Transfers

B. Expenditures of Capital
(No item VI. found)
VII. Capital Expenditures

C. Financial Transactions
VIII. Loans
IX. Payments of principal, interest and commissions to creditors

Each month, the municipality and county prepares the Annex No. 10 report, reporting budget to actual, one for each expenditure chapter and one for revenues.

The difference between projected local revenue and expense is the required state subsidy request. The municipality and county project their revenues and expenditures and calculate the requested State subsidy as part of the budget process.

Regia

The regia CY1997 budget presents two years of data, the CY1996 actual and the CY1997 as planned. The budget presents by line-item the CY1996 actual and the CY1997 budget in total, by quarter, and by total again. The regia budget shows all budgeted revenues, then all budgeted expenses. The regia budget also includes 11 additional budgets or schedules as follows:

— Distribution of Net Profit
— General Budget
— Budget of Production Activities
— Treasury Budget
— Hard Currency Payments
— Resources and Expenses for Social, Cultural, and Support Activities
— Reserve Fund
— Expenses Incurred from Revenues Received
— Distribution of Liquidities
— Investment/Development Fund
— Correlation with Public Budget

Tax on Income

Regia pay a gross income tax and a net income distribution to the municipality or county government. The first payment, gross profit tax, is based on the formula:

Revenues - Expenses = Gross Profit.

The gross profit is multiplied by 38 percent to derive the gross income tax payment. The income tax payment is deducted from the gross profit to derive net income. The distribution of net income is as follows:

— 10 percent of net profit goes to a regia employee and management fund;
— 50 percent of net profit goes to the municipality or county (separate from the 38 percent income tax); and
— 40 percent of the net profit goes to the regia retained earnings where it can sit, be reinvested, or paid to the municipality or county (in addition to the gross and net profit taxes).

FIXED ASSETS AND DEPRECIATION ACCOUNTING

Principles

Four overriding principles govern the treatment of fixed assets and depreciation accounting:

- Business entities, including public institutions, must register in their accounting records their fixed assets at historical cost, their depreciation and the net book value for any fixed assets with a value greater than 200,000 lei and a useful life greater than one year, in accordance with Law 82 of 1991 and Law 15 of 1994 regarding the depreciation of fixed assets. This treatment is consistent with International Accounting Standard 16 regarding the property, plant and equipment and IAS 4 and 5 which deal with depreciation and financial statement presentation, respectively. In general, public institutions should annually record the acquisition and retirement of fixed assets at historical costs and depreciation. However, municipal and county governments do not record depreciation in accordance with cash basis accounting. Regii, on the other hand, record depreciation in accordance with Law 15 of 1994 and with the various depreciation and utilization decrees issued by the Ministry of Finance.

- State-owned companies must and businesses may revalue their fixed assets for financial statement purposes as of June 30, 1994 to reflect the impact of inflation on the balance sheet in accordance with Decree 500 of 1994 issued by the Ministry of Finance. Generally, regii should have revalued their fixed assets as of June 30, 1994 in accordance with this decree. However, financial statements prepared after June 30, 1994 (specifically December 31, 1995 and 1996) are not restated in accordance with inflation accounting principles. The Ministry of Finance inflation norms are only applicable through June 30, 1994.

- Large tax payers may revalue their fixed assets for tax purposes (not financial statement purposes) in accordance with Ordinance 70 of 1994 as amended by Law 73 of 1996, provided they meet two thresholds: annual revenues of at least 10 billion lei and employ at least 299 employees.

- International Accounting Standard (IAS) 29 provides guidance for the revaluation of fixed assets to restate financial statements in hyperinflation economies. Based on existing inflation, Romania would meet the criteria by which the principles of IAS 29 would apply. However, the application of fixed assets inflation accounting in Romania is limited for tax purposes and not financial statement purposes beyond June 30, 1994.

Chronological View

The accounting for fixed assets in Romania has evolved as follows:

- The fixed asset net book value shortly after the 1989 revolution were deemed to be obsolete by the Ministry of Finance. The books of account needed to be revalued for accumulated depreciation and net book value to properly reflect true economic value. Accordingly, the Ministry of Finance issued Law 945 in 1990, to adjust depreciation. This decree accelerated depreciation, resulting in a higher accumulated depreciation and a lower net book value.

- Shortly after the revolution, the country experienced a 200 percent inflation rate. Thus, the fixed assets presented on the financial statements did not reflect a fair value in a hyperinflationary economy. Accordingly, the Ministry of Finance promoted the promulgation of Law 26 in 1992 which applied an inflation index to restate the fixed assets. The book value and the accumulated depreciation were adjusted based on the inflation index. Depreciation would continue to be calculated.

- By 1994, the country continued to experience hyperinflation. The 1992 inflation decree was only applicable through the first quarter of 1992. Accordingly, the financial statements did not properly present the financial position relative to inflation. Thus, the Ministry of Finance issued Decree 500 of 1994, which provided inflation indexes through the second quarter of 1994. Financial statements were restated based on inflation indexes through June 30, 1994.

- Also in 1994, the Ministry of Finance promoted the promulgation of Law 15, Depreciation of Fixed Assets, which provided depreciation and tax guidance for small tax payers and depreciation guidance for large tax payers. Each category of fixed assets was assigned a revised useful life; the economic life was generally reduced, allowing for a larger depreciation expense, for accounting purposes. Large taxpayers were provided tax guidance through Ordinance 70, also passed by the Ministry of Finance in 1994.

- The Ministry of Finance then promulgated Utilization Coefficient Norms for 1995 and 1996 in order to provide further depreciation guidance. These norms allowed business entities to reflect the depreciation expense based on the degree to which fixed assets contributed to revenue generation. These norms incorporated the concept of utilization coefficients which related annual revenues to the average fixed asset value of the year. The coefficient of the current year was compared to the coefficient of the prior year to determine a percentage. This percentage would be used in the depreciation expense calculation. The concept of utilization coefficients is consistent with the objective of showing increased profits for state-owned enterprises. The utilization coefficients reduced depreciation expense, thereby increasing net income.

Application

- Municipal and county governments do not depreciate their fixed assets but do maintain records of fixed assets.

- Generally, regii would inherit related fixed assets from their local municipal and county governments which were recorded at historical costs. Accumulated depreciation and net book value of these fixed assets needed to be recorded. Depending on the timing of the start-up of the regii, the regii would need to follow the applicable laws as described above.

- For example, the County regia in Targoviste, inherited certain fixed assets (roads) as of October, 1994. The fixed assets needed to be reevaluated and the depreciation needed to be readjusted from the date on which it received the fixed assets through June 30, 1994. Depreciation expense for the 1995 and 1996 needed to be computed based on the Ministry of Finance utilization coefficient decrees of 1995 and 1996. The result was a utilization degree of 75 percent which reduced depreciation expense, increased net income and increased the taxes paid by the *regii* to the county. The remaining 25 percent was booked as an extraordinary expense not deductible for tax purposes.

- With respect to the City regii of the City of Targoviste, the regii inherited the fixed assets (potable water, public transportation, markets and fairs, solid waste and landfill, greenhouse, flats, and nationalized housing) in December, 1995. The result was a utilization degree of 35 percent which reduced depreciation expense, increased net income and increased the taxes paid by the regii to the county. The remaining 65 percent was booked as an extraordinary expense and not deductible for tax purposes.

- Depreciation, including utilization coefficient procedures, as practiced in these two cases, resulted in reducing depreciation expense, increasing gross and net incomes, thereby increasing the income tax payments (gross payment and distribution) by the *regii* to the respective local governments. While these depreciation procedures are consistent with Romanian law, they do not appear to be consistent with generally accepted accounting principles, or with IAS 16, Property, Plant and Equipment, which addresses this issue. Further, it is not clear how many *regii* reported reduced depreciation expense based on these procedures. This will need further research.

Utilization Coefficients

Romanian accounting practices use a utilization coefficient to determine the amount of depreciation to be charged and reported. Utilization coefficient guidance is provided in the Utilization Coefficient Decree Norms of 1995 and 1996. The formula is based on comparing two years of operating revenue and the average value of the fixed assets:

$$\frac{\text{Prior Year Operating Revenues}}{\text{Prior Year Fixed Assets Average Values}} = \text{Coefficient} \quad \text{(say 1.30)}$$

$$\frac{\text{Current Year Operating Revenues}}{\text{Current Year Fixed Assets Average Values}} = \text{Coefficient} \quad \text{(say 1.55)}$$

The current year's coefficient is compared to the prior year's coefficient to determine a percentage in the following formula.

$$\frac{\text{Current Year Coefficient}}{\text{Base Year Coefficient}} = 84\%$$

Then, 1.30 is divided by 1.55 = 0.84, which is applied to the depreciation expense. This reduces the depreciation expense to 0.84 of the normal amount which thereby increases net income.

The accounting theory issue concerns the extent to which fixed assets contribute to revenue generation. The normal assumption is 100 percent and therefore utilization coefficients are not used. Romanian accounting has used the utilization concept to reduce depreciation and increase net income.

INFLATION ACCOUNTING

Inflation accounting follows the standards provided in International Accounting Standard (IAS) 29: Financial Reporting in Hyperinflationary Economies. It is based on the premise that the reporting of operating results and financial position in the local currency without restatement is not useful. In most countries, primary financial statements are prepared on the historical cost basis of accounting without regard either to changes in the general level of prices or to increases in specific prices of assets held, except to the extent that property, plant and equipment and investments may be revalued. However, some enterprises present primary financial statements that are based on a current cost approach that reflects the effects of changes in the specific prices of assets held. In hyperinflationary economies, financial statements, whether they are based on historical cost or current cost approaches are useful only if they are expressed in terms of the measuring unit current at the balance sheet date. Consequently, IAS 29 applies to the primary financial statements of enterprises reporting in the currency of a hyperinflationary economy. Presentation of the information required by IAS 29 as a supplement to unrestated financial statements is not permitted.

This standard applies if any of the following characteristics exist:

- The general population prefers to keep its wealth in nonmonetary assets or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power.

- The general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency.

- Sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period even if the period is short.

- Interest rates, wages and prices are linked to a price index.

- The cumulative inflation rate over three years is approaching or exceeds 100 percent.

IAS 29 provides specific guidance to restate historical cost financial statements and current cost financial statements. In Romania, primary financial statements are based on historical costs, so the current cost restatement principles are not applicable.

Applicable historical cost balance sheet restatement principles include:

- Balance sheet amounts not already expressed in terms of the measuring unit current at the balance sheet date are restated by applying a general price index.

- Monetary items are not restated because they already are stated in terms of the monetary unit current at the balance sheet date.

- Assets and liabilities linked by agreement to changes in prices, such as index linked bonds and loans, are adjusted in accordance with the agreement in order to ascertain the amount outstanding at the balance sheet date.

- All other assets and liabilities are non monetary. Some nonmonetary items are carried at amounts current at the balance sheet date, such as net realizable value and market value, so they are not restated. All other nonmonetary assets and liabilities are restated.

- At the beginning of the first period of application of IAS 29, the components of owner's equity, except retained earning and any revaluation surplus, are restated by applying a general price index from the dates the components were contributed or otherwise arose.

Applicable historical cost income statement restatement principles are that all items in the income statement are expressed in terms of the measuring unit current at the balance sheet date. Therefore all amounts need to be restated by applying the change in the general price index from the dates when the items of income and expenses were initially recorded in the financial statements.

Applicable gain or loss on net monetary position principles may be estimated by applying the change in a general price index to the weighted average for the period of the difference between monetary assets and monetary liabilities. The gain or loss on the net monetary position is included in net income. Other income statement items such as interest income and expense and foreign exchange differences related to invested or borrowed funds are also associated with the net monetary position.

For Romanian governmental financial statements, the applicability of IAS 29 relates to fixed assets and inventory accounting, where the revenues exceed 10 billion lei annually and have greater than 299 employees. No local government nor regii meets these thresholds as far as we know. Therefore, only the national regii qualify for the inflation adjustment. Romania has consistently experienced an annual inflation rate of about 50 percent which would qualify under IAS 29 criteria.

For fixed assets and inventory, the restated cost, or cost less depreciation, of each item is determined by applying to its historical cost and accumulated depreciation the change in a general price index from the date of acquisition to the balance sheet date. Thus fixed assets and inventories are restated in Romania. Investments, goodwill, patents, trademarks and similar assets may also be restated. Inventories of partly-finished and finished goods are restated from the dates on which the costs of purchase and or conversion were incurred.

Ordinance 70 of 1994 provides guidance for large taxpayers. The result is that large tax payers restate the “basic” financial statements to “fiscal” financial statements in accordance with IAS 29**.**

ISSUES AND RECOMMENDATIONS

The purpose of this section is to present accounting recommendations or other legal, regulatory reforms or other measures required to bring current municipal accounting standards and practices into conformity with recognized international standards and to enhance a municipal credit finance system.

Accounts Receivable

There are no accounts receivable nor bad debt expenses established on the balance sheet and Annex reports for the municipality or county during the year or at year end. Thus the balance sheet does not present the full financial position of the municipality or county. Accounts receivable can be established with revenue deferrals and allowances for uncollectible accounts on the balance sheet. Subsidiary accounts exist for both individuals and businesses which document the original amount owed, amounts paid and the balance owed. While the bad debt expense can be recorded in the detailed accounting records, it is not presented on the income statement and is not considered as an offset to the accounts receivables account.

Romanian local governments should include accounts receivables on the balance sheet and bad debt expense on the income statement. Bad debt expense should be recorded and offset the accounts receivable and may be presented as a gross amount or netted with the accounts receivable. This suggestion is consistent with fair presentation of the financial position of the government and could also increase control over the receivables.

Program Budget

The budget process focuses on line-items and is based on an incremental approach to budgeting. The budget does not present information based on programs nor performance data based on outputs of services provided nor outcomes based on the impact of the services on the public. The Romanian government should consider supplementing the line-item budget presentation with a program or performance based budget which provides output and outcome based information.

Inflation Accounting

There are two related to inflation accounting, as practiced in Romania:

- The first deals with the Revaluation of Fixed Assets, Decree 500 of 1994. The Ministry of Finance guidance for fixed assets revaluation is valid through June 30, 1994. Financial statements prepared after June 30, 1994 are not presented fairly relative to inflation. Given inflation rates, the Ministry of Finance should, at a minimum, provide for revaluation through December 31, 1996.

- The second issue deals with the application of the fixed assets revaluation for tax purposes and not for financial statement restatements. For 1995 and 1996, Romanian businesses, including regii which meet the thresholds restated their financial statements to a fiscal basis. This restatement was not for financial statement purposes. Accordingly, the restatements do not conform to the intent of IAS 29. The treatment of the revaluation of fixed assets consistent with Decree 500 and the restatement of fixed assets for tax benefits should both be further reviewed.

Depreciation Accounting

Depreciation accounting as practiced in Romania, while embodying some inflation accounting principles, appears to be based on a methodology designed to decrease depreciation expense and increase gross income in order to increase the income tax payments and distributions from the regii to the local governments. While this treatment is consistent with Romanian law, it is not consistent with generally accepted accounting principles and should be subject to further analysis.

International Accounting Standards

Compliance with existing laws governs the governmental accounting principles in Romania. The country is considering adopting the full provisions of European Directive No. 4. The British Know How Fund is currently reviewing the application of international accounting standards as reflected in this Directive to the business entities in Romania. The government of Romania should consider expanding this analysis to Romanian local governments and regii.

Additional Financial Statements

Regii do not currently prepare a statement of cash flows. The government of Romania should consider including these statements as required annually. The statement of cash flows is consistent with international accounting standards.

ATTACHMENT A

THE REGIA BALANCE SHEET

ASSETS
- Fixed Assets
  - Intangible Fixed Assets
  - Tangible Fixed Assets
  - Financial Fixed Assets
- Current Assets
  - Stocks
  - Inventories
  - Accounts Receivable and Liquidities
- Transitioning Accounts
  - Regularization and Assimilated Accounts
  - Premium Regarding the Repayment of Debt

TOTAL ASSETS

LIABILITIES
- Own Capital
  - Profit
  - Loss
  - Profit Distribution
  - Funds
  - Shares from the Development Fund
  - Subsidies for Investments
  - Regulated Provisions
- Provision of Risks and Expenditures
- Debts
  - Loans and Assimilated Debts
  - Suppliers and Assimilated Accounts
  - Client Creditors
  - Other Debts
- Regularization and Simulated Accounts

TOTAL LIABILITIES

ATTACHMENT B

THE REGIA INCOME STATEMENT

REVENUES FROM CORE ACTIVITY
- Revenues from goods (merchandise) sold
- Revenues from Core Activity
- Turnover
- Inventories evaluated
- Assets in process evaluated
- Total production
- Subventions for core activity
- Other revenues
- Revenues from provision of core activity

TOTAL REVENUES FROM CORE ACTIVITY

COSTS FOR CORE ACTIVITY
- Merchandise
- Raw materials
- Consumables
- Energy and water
- Other materials
- Total materials
- Other costs
- Taxes
- Personnel
- Labor burden
- Total personnel
- Other operational costs
- Depreciation for core activity

TOTAL COSTS FOR CORE ACTIVITY
PROFIT OR LOSS CORE ACTIVITY

FINANCIAL ACTIVITY
- Financial revenues
- Interest expense
- Amortization expense
- Total financial costs

PROFIT OR LOSS FINANCIAL ACTIVITY

CURRENT PROFIT OR LOSS
EXTRAORDINARY REVENUES/COSTS

GROSS PROFIT OR LOSS
- Income Tax
- Prepaid Tax

NET PROFIT OR LOSS

ATTACHMENT C

THE MUNICIPAL/COUNTY BALANCE SHEET

ASSETS

A. FIXED ASSETS, LAND AND ITEMS IN THE STOCK
   - Fixed assets and land
   - Items of Inventory

B. RESOURCES, SETTLEMENTS, EXPENDITURES AND MATERIALS
   - 3. Budgets of institutions
   - 3.1 Resources available
   - 3.2 Resources and other values
   - 3.3 Settlements and debtors
   - 3.4 Expenditures
   - 3.5 Materials

   TOTAL ASSETS

LIABILITIES

A. FUNDS
   - Fixed assets and land
   - Items of Inventory

B. FINANCING FROM THE CENTRAL BUDGET, OWN REVENUES, SETTLEMENTS AND OTHER SOURCES
   - 3. Budgets of institutions
   - 3.1 The financing of institutions
   - 3.2 Extrabudgetary revenues
   - 3.3 Settlements, debtors, and other sources
   - 3.4 Special purpose sources

   TOTAL LIABILITIES

ATTACHMENT D

MUNICIPAL/COUNTY REVENUE SOURCES
(Source: Annex 12 Account of Execution of Revenues and Expenditures)

I. Current Revenues
A. Fiscal Revenues
A1. Direct Taxes
Taxes and Fees on the Population
- Taxes on independent professionals and others
- Taxes on buildings and land owned by physical persons
- Fees on transportation means owned by physical persons
- Stamp duties
- Other taxes and fees

Fees for the Use of State Owned Land
Taxes on Buildings and Land Owned by Legal Persons
Fees on Transportation Means Owned by Legal Persons
Taxes on Agricultural Revenues
Other Direct Taxes
- Income taxes on non-residential physical and legal persons
- Other returns from direct taxes

A2. Indirect Taxes
Taxes on Shows
Other Indirect Taxes
- Stamp duties collected from legal persons
- Overdue increase and penalties for unpaid revenues
- Other indirect tax returns

Payments from Net Profit of the Regii
Payments by Public Institutions
- Fees for examination of drivers and other road use related fees
- Payments from public institutions' availabilities and self-financing activities
- Other public institution revenues

Other Revenues
- Revenues from the recovery of court expenditures, charges and damages
- Revenues from fines applied according to legal provisions
- Refunds from the financial budgeting of previous years
- Refunds out of concessions
- Returns from other sources

II. Revenues from Capital
Revenues from Capitalization of State Owned Goods
- Revenues from the sale of some goods owned by public institutions
- Revenues from the sale of housing build out of state funds

III. Shared Revenues from State Budget Revenues
Shared Income Tax
Allocation from wage tax

IV. Subsidies Received from the State Budget

- Subsidies received by local budgets for social assistance, heating, and public transportation
- Subsidies received by local budgets for investments
- Subsidies received by local budgets for investments partially financed out of external loans

V. Donations

VI. Loans

Short-term Loans from the Treasury Fund
Short-term Loans from the State Treasury
Working Capital Loans

ATTACHMENT E

MUNICIPAL/COUNTY EXPENDITURE ACCOUNTS
(Source: Annex 14 Detailed Description of Expenditures)

A. Running (Operating) Expenditures

I. Personal

- Wages
- Basic wages rate
- Merit wages
- Managerial allowances
- Seniority allowances
- Allowance for work under special conditions
- Time wages, payments for additional working hours
- Bonus fund
- Other payment rights
- Share for state social insurance
- Expenditures for the unemployment fund
- Travel and transfer expenses
- Travel and transfer within the country
- Traveling in foreign countries

II. Materials and services

- Social rights
- School manuals and supplies
- Transportation for pupils, students, disabled or ill persons, and their companions
- Pupils and students' rights over periods of competitions
- Rights for blood donors
- Other rights established by law
- Food
- Human food
- Animal food
- Drugs and sanitary materials
- Drugs
- Sanitary materials
- Maintenance and administrative expenses
- Heating
- Lighting and motor power
- Water, sewerage and waste disposal
- Postage, telephone, fax, radios, TV
- Office supplies
- Cleaning materials
- Other materials and services
- Current repairs
- Capital repairs
- Books and publications
- Other expenditures
- Professional specialization of employees
- Protocol
- Labor protection
- Other expenditures authorized by legal provisions

III. Subsidies
- Subsidies for public institutions
- Subsidies per types of products and activities
- Subsidies for covering price and tariff differences

IV. Subsidies granted to agricultural producers

V. Transfers
- Consolidable transfers
- Transfers from the state budget to the state social insurance budget
- Transfers from the state budget to the unemployment fund
- Transfers from the state budget to the special hazard and accident fund for unemployment insurance
- Transfer from the state budget to the special fund for the payment of pensions and of other social insurance rights of the agricultures
- Non-consolidable transfers
- Housing
- Grants
- Allowances and assistance for children
- Pensions and IOVR assistance, for military personnel and others
- Social assistance
- Other kinds of assistance, allowance and premia
- Premium from the financial recovery fund with the government
- Shares and quotas to international bodies
- Transfers abroad
- Interest rate difference for subsidized banking credits
- Co-financing technology development, technological transfers, and research capital
- Other transfers

B. Expenditures of Capital

(No item VI. found)

VII. Expenditures of Capital
- Stocks for the state and mobilization reserve
- Investments by public institutions
- Investments by Regii and state owned commercial companies
- Investments by public institutions and of self-financing units

C. Financial Transactions

VIII. Loans
- Loans from the financial recovery fund with the government
- Loans for finalizing objectives approved by bilateral conventions and inter-governmental agreements

IX. Payments of creditors, interest and commissions to creditors
- Repayment of external credits
- Repayments of interest and commissions to external credits

NOTE: No line item for bad debt expense; no section B. VI.