

Study on the Particular Accounting Practices of Small and Medium Companies

C. Nicolaescu

Cristina Nicolaescu

Faculty of Economics, "Aurel Vlaicu" University of Arad, Romania

Abstract

This article aims to analyse the particularities of small and medium companies in Romania in order to propose a set of practices in accounting terms for these economic entities. To this end has started from the best practice recommendation adopted by the European Commission in November 2008 and guidelines developed by the Small and Medium Practices Committee of the International Federation of Accountants, trying to adapt them to a concrete situation, to the particular situation of small and medium enterprises of Romania. The study features were analysed economic and psycho-social, determined by the mentality of small and medium business owners in Romania and their attitudes about accounting information.

Keywords: accounting, SMEs

The importance of small and medium enterprise sector in a country's economic welfare comes from the fact that a sector of thriving small and medium enterprises means increase, innovation, and jobs. According to Organization for Economic Cooperation and Development small and medium enterprises represent over 95% from enterprises and for 60-70% of jobs in OECD countries.

In Romania, small and medium enterprises represent the majority of the economic entities and the most part of the jobs from the private sector and gross domestic product. We assist at an increasing in

the number of SMEs, during the 2003 – 2008 period, from 347,064 in 2003 to 532,148 in 2008.¹

The Report of the National Council of Private Small and Medium Enterprises in Romania states that in 2009 the number of small and medium businesses increased by 2600 (6.3%) compared to 2008. The sector of small and medium enterprises represents 97,8% from the total number of enterprises. Mostly small and medium enterprises engaged in trade, being in 2009 about 18 thousand units, or 41.2% of total small and medium enterprises. In manufacturing, there have enabled 5,1 thousand small and medium enterprises, or 11,7% of total small and medium enterprises.

Also, because studies have shown that professional accountants are considered to be competent consultants and trustworthy, being the most popular source of external advice and support for small and medium, were created by international professional bodies concerned with the development of specific standards for small and medium enterprises.

The most active and important of these bodies is the Committee for Small and Medium Practices International Federation of Accountants. The Committee has formal working procedures, teams on projects, strategic and business plan, a communication plan and a permanent technical director. Among his responsibilities was the development of international standards - mainly, audit and certification, ethics and accounting - by providing information in the process of normalization.

Committee assignments are aimed at ensuring the relevance of standards for EMP's and SMEs and their efficient implementation in terms of cost. Of a particular importance for small and medium practices implementation within SMEs have materials developed by this committee: the Guide of Using International Standards on Auditing and Certification for Auditing Small and Medium Entities, the Guide of Quality Control for Small and Medium Practices, The Practice Management Guide for Small and Medium Enterprises, published in June 2010, comprising 8 modules largely independent on issues such as planning, human resources management and customer relationship

¹ Cioarna, Al., Cilan, T. - „The impact of the contemporary economic crises on the small and medium enterprises”, Theoretical and Practical Approaches in Economics, 2010

management and is accompanied by the forms and task lists and an internal procedures manual.

Regarding the European Commission, in November 2008 it adopted a true accounting manual for small and medium enterprises which includes detailed information on good practice: USERS AND THEIR NEED FOR FINANCIAL STATEMENTS (users and needs), ACCOUNTING SYSTEMS (internal and external accounting, tax accounting), ACCOUNTING FRAMEWORK (accounting principles and principles for external financial statements), RECORDING OF ACCOUNTING TRANSACTIONS (Financial records, Double-entry bookkeeping and Chart of accounts), COMPONENTS OF FINANCIAL STATEMENTS (Profit and loss account, Balance sheet, Cash flow statement, other financial statements)²

Next, we analyse how these recommendations are applicable to small and medium enterprises in Romania.

From the outset, it should be noted that in Romania under current law (the Accounting Law of 2009 and 3055 OMPF) accounting system is unique for all businesses regardless of their size. All companies in Romania are obliged by law to organize their financial accounting activity into double entry and use the General Plan of Accounts unlike other European Union countries where legislation is adapted to various types of companies.

3055 OMPF provides the format and content of annual financial statements, accounting principles and rules of recognition, evaluation, removal of records and elements presentation in the annual financial statements, drafting rules, approval, audit / verification, according to law, and publish annual financial statements, some rules on management accounting, General Plan Accounts, content and function accounting accounts, establishing rules and regulations on organization and management accounting and reporting in accordance with the requirements of state institutions, for all users. The rules in this Order shall apply to all companies regardless of legal form or size of their.

The only changes that occur are those related to the content of annual financial statements creating a basic set, including balance sheet, the profit and loss account, statement of changes in equity, cash flow statement, and the explanatory notes to the annual financial statements,

² Final Report of the Expert Group “Accounting system for small enterprises - Recommendation and Good Practices/November 2008

and an abbreviated balance sheet model, and a profit and loss account and explanatory notes, the other components are optional.

In these circumstances it is obvious that we can not speak about small and medium recommendations regarding accounting organization, but using the 3055 OMPF created and recommendations of international organizations can offer concrete practices adapted to the particularities of these entities.

This is necessary because it is totally useless and irrelevant for an SME to apply the same rules as large companies and very large ones. This statement is valid for other models and accounting procedures such as accounting and inventory forms.

As can be seen in the presentation, components developed by the European Commission recommendations are based on the users of accounting information and their information needs. This approach is in full accord with the basic objective of providing images that accurate accounting of company assets and results of all categories of users. 3055 OMFP, section two, shows issues in use of accounting information and qualitative characteristics of information.

Here it is necessary to make some observations on the existence of these users and small and medium enterprises.

The importance of accounting as a source of information for owners and managers of small enterprises and their different stakeholders is obvious.

Theoretically, at small enterprises are the same categories of users, but there are a few references. Practically, in Romania if we refer to most businesses from this category, they organize their accounting information not only for information needs but also for the fact that is required. Starting from this sad reality we can say that the main user of accounting information is the state by tax authorities.

Where companies have or intend to contract bank loans and financial institutions are users of information provided by small and medium enterprises.

Yes, indeed, there are business owners who want to know the regular economic and financial situation of their enterprises or managers (often in Romania in these types of businesses even owners) who make decisions based on accounting data, but unfortunately too few. Why? I have identified two causes: the first is that many times, in these companies they do not apply the principle assets of the business entity and it gets to be confused with the property owners themselves, and the

second is that many managers / owners have the impression that they know everything about their business and can make decisions without consultation with the chartered accountant, who often can stop the momentum of the great business (and usually he knows why ...). These two cases may explain, in part, many financial failures in connection with these enterprises. Another reason could be to establish minimum initial capital for limited liability companies at 200 lei. As most companies in this category are limited liability companies, many business owners turn this minimum capital. How clearly this is not enough to cover the costs of establishing the company, is borrowed by a company owner, automatically leading to the financing entity, which in future will lead to negative equity.

In terms of customers and suppliers as users of accounting information to these companies either carry out operations with the same suppliers and customers for long periods of time, or operations are paying cash on the spot or small values. In these circumstances knowledge through accounts, knowledge of business partners is not so important.

Employees and the public are not too interested in these entities because of their small size and importance.

The second aspect of the analysis on small and medium firms to establish best practice is on accounting categories that can or should be organized at their level. In most EU countries in this category are not required to organize the management accounting (internal or managerial). In Romania under the Accounting Law (Law 82 of 1990 with subsequent amendments and updates), it is mandatory even for small companies, which means additional costs for these companies without necessarily the need for information internal to the organization of these records request. Managerial accounting concepts are based precisely on the idea of a strict accounting of the user tailored information internally, the only beneficiary of these records, which means that it should be organized only for certain periods or certain sectors of the business. In Romania this requirement is impossible due to the organization of these permanently records.

Financial accounts or general in charge of processing the external flow is present and regulated at the level of SMEs, which is perfectly correct with a little observation, which is the subject of this article, namely the need to adjust certain aspects of financial accounting to the specifics of these entities.

In addition, the two types of accounts that businesses regardless of their size must not forget to organize tax component. The only feature that benefit small businesses on this level is able to submit statements of the main current (those relating to the consolidated social contributions and VAT) each quarter.

Given the previously stated it is obvious that the difference between a large enterprise accounting organization and a low or very low is almost non-existent! In these circumstances the work of an accountant's work is almost as laborious as in the case of small and large those (works the same, both accounting and tax, but differs from the value of transactions). But a small business, most often can not afford to pay an accountant or accounting services accounting firm or an accounting practice as a large enterprise. The result is that the vast majority of small and very small businesses will pay small amounts of accountants and accountants will provide services to these categories of enterprises on the extent of the payment (crappy quality), being forced to provide services to more many small (sometimes tens ...) to get decent amounts. It's obvious that tax and accounting statements prepared under these conditions are likely to be incorrect, with all ensuing consequences (lack of confidence among users of financial reporting and thus adversely affect the capital cost of enterprise development, medium-term uncertainty long, business leaders and exposure to acts punishable by the laws of the land and deeds, tax evasion and uncertainties in determining the taxable base, and applying the correct calculation of tax liabilities for other users of financial statements: banks and other credit institutions insurance institutions, investors, employees, etc.. misleading when making their own decisions about the business concerned, for the population: not determining the correct tax liability may cause the Government to introduce new taxes or increase existing ones for accounting in question: the insecurity of the "business" and its exposure to civil or criminal penalties provided by law).

The solution of such problems could be, in my opinion, simplify accounting organization to these categories of company, by establishing a completely separate set of flexible rules, adapted and completed strictly business peculiarities of simple guides to good practice, allowing accountants to leading accounts of these entities in order to facilitate the work without harming the quality of accounting information.

But it seems that in Romania, unfortunately, things take a different path because, under proposed amendments to the draft accounting law in December 2010 accounts of these entities will not only simplify, but also new types of entities before they could simple entry accounting organizations (freelancers, professional offices) will be required to apply the double entry accounting!

Fundamental accounting principles applicable to small and medium enterprises are subject to both the European Commission's report for small and medium-sized practices and Order 3055 in 2009.

According to the Commission Report, in the most European countries accounting principles applicable to such companies are less than for large firms.³

In Romania, however, explicitly required the nine principles OMPF 3055 (according to Section VII of the Finance Order 3055/2009) are required for all businesses regardless of their size.

According to the Principle-based accounting, in Romania, practiced accounting is accrual accounting in which revenues and expenses are recognized when they occur. In my opinion, when an enterprise is a micro or even a very small enterprise, it might be more appropriate to use cash basis accounting. In this case the accounting and the resulting financial statements are prepared on a cash basis. A cash basis means that a cost or an income is accounted at the equivalent amount of cash paid or received for it. Some European states use cash basis accounting for taxation of small enterprises and other consider it sufficient for external accounting of micro enterprises in their local GAAP.

Very important for SMEs is how to interpret the application of the principle of materiality. According to this principle, if information is of such magnitude that it has no influence on the user's judgment and decision-making, it can be left out. The accounting transactions of an enterprise need to be recorded in the accounting books. Some form of recording will be essential to all businesses for the day-to-day management of their operations and the fulfilment of unavoidable governmental obligations (e.g. taxation). It is well known that inadequate record keeping is frequently associated with failures in small businesses even if it is not actually the direct cause of failure (*Final*

³ Final Report of the Expert Group "Accounting System for Small Enterprises, and Good Practices Recommendation / November 2008, Annex 4

Report of the Expert Group "Accounting system for small enterprises - Recommendations and Good Practices/November 2008). For record keeping purposes the enterprise can use different methods, small businesses can choose those methods that are best adapted to the complexity (or rather lack of complexity) of its activity. With other models and procedures of accounting method should be developed separate sets of rules for small businesses. We can refer here to the accounting and inventory forms. Thus, the records required to be used are often too many and too complex for small businesses, with many completing data (completely irrelevant, most times!) and many signatures (provided that if these businesses have one employee or business owner only!). Sadly, in this case, is that if certain sections of the document (which is usually typed) not working (no data because they are not relevant or necessary) organs of control may consider these documents as incomplete and as following their registration in the accounts is offense!

Also, in the case of inventory, the procedure is almost the same for all categories of businesses with few exceptions in the composition of the inventory committee (Order no. 2861/2009 of 9 October 2009 for approval of the norms on the organization and inventory of assets, liabilities and equity). Commendable is the fact that the rules for conducting heritage inventories established by Order 2861 of 2009 provides that "the entities whose number of employees is low, the inventory can be done by one person. In this situation, responsible for inventory accuracy is the administrator, officer or another person who is liable for entity management".⁴

Although this study focuses on small business accounting does not mean we can not refer also to tax abuses faced by small businesses because it is unfair to put small businesses on the same level in terms of taxation, with larger ones. Often, a large fine that does not mean a significant financial effort for a large company, applied to a small business can result in its bankruptcy. Also penalties, interest and delay penalties imposed for late payment of tax, burden on small businesses more. All these while the damage caused to the state budget by these companies is much lower than that caused by the large taxpayers, however, the state is more sympathetic towards the latter ones.

⁴ Order no. 2861/2009 of 9 October 2009 for approval of the norms on the organization and inventory of assets, liabilities and equity

Eliminating the income tax for small businesses and the introduction of minimum tax were so many ways to increase the tax burden on these categories of businesses and I am confident that these measures have led only to a voluntary closure or bankruptcy of many small businesses without having increased the state income.

We must not forget the multitude of authorizations, licenses, taxes, fees and costly formalities to be fulfilled by any company regardless of its size, depending only on the domain of activity (fire protection, safety, environmental protection, etc.).

Conclusions

In conclusion, in Romania, taking into account the importance and the many small and medium enterprises, the state, through its bodies should be more concerned about the welfare and development of these entities, through the promulgation of measures encouraging both accounting and tax plan.

An accounting measure that we propose based on the study are: eliminating the mandatory of management accounting by those entities; simplification of financial accounting in line with the need of accounting information at the level of business and complexity of their work in accordance with the principle of relative importance; greater flexibility relative to contents of forms used by the entity's accounting and eliminate unnecessary forms; possibility of using a cash accounting system for small and very small,

Other features of these entities and adopted measures that can improve their work and reduce the failure could be: the minimum registered capital required for limited societies. Possibly could establish differentiated levels of activity depending on the subject. The value of the minimum capital should be sufficient to enable and support business start up to obtain their own resources; fines and delay increases differentiated by size of enterprise, simplifying of tax procedures to these enterprises by reducing the number of statements.

The accounting measures will necessarily be accompanied by the development of special guidelines for best practices for small and medium enterprises in Romania, because the guidelines used in the European Union does not correspond of the situation of our country.

Bibliography

Cioarna, Al., Cilan, T (2010). *The impact of the contemporary economic crises on the small and medium enterprises*, Theoretical and Practical Approaches in Economics

Final Report of the Expert Group “Accounting System for Small Enterprises - Recommendation and Good Practices (November 2008)

Legea contabilității nr.82 din 1990, cu modificările și actualizările ulterioare.

Ordinul nr. 2861/2009 din 9 octombrie 2009 pentru aprobarea Normelor privind organizarea și efectuarea inventarierii elementelor de natura activelor, datoriilor și capitalurilor proprii.

Ordinul Ministerului Finanțelor Publice nr. 3055 privind reglementările contabile conforme cu Directivele Comunităților Europene.

<http://www.cnipmmr.ro/statistica/statistica.htm>.

