

# audit

## FINANCIAR

Anul XIV, nr. 144 - 12/2016

12/2016

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- **The adoption of integrated reporting principles by the Romanian companies listed at the Bucharest Stock Exchange**
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- **Financial risk identification and control of cross-border merger and acquisition enterprises**

**Studiu privind amprenta factorilor culturali asupra sistemelor de contabilitate managerială**

**Study regarding the impact of cultural factors on management accounting systems**

# Premiile revistei „Audit Financiar” pentru anul 2016

În luna noiembrie redacția revistei „Audit Financiar” a acordat premii autorilor articolelor publicate în anul 2016.

**Premiul special de excelență** a fost acordat doamnei profesor universitar doctor Liliana Feleagă, de la Academia de Studii Economice din București. Premiul a fost oferit pentru susținerea permanentă a revistei manifestată prin articolele publicate, recenziile efectuate, promovarea publicației în mediul academic.

**Premiul de excelență „Constantin Ionete”** a fost acordat doamnei conferențiar universitar doctor Ionela-Corina Chersan, de la Universitatea „Alexandru Ioan Cuza” din Iași, pentru articolul „Studiu privind practici și tendințe în auditul intern în România și în lume”. Articolul a fost publicat în revista Audit Financiar nr. 141/2016 și abordează o temă de interes pentru membrii Camerei Auditorilor Financiar din România. Acesta a fost articolul cel mai descărcat de pe pagina web a revistei după data publicării sale.

**Premiul de excelență „Alexandru Rusovici”** a fost acordat doamnei doctorand Sînziana-Maria Rîndașu, de la Academia de Studii Economice din București, pentru publicarea articolului „Securitatea informației – o nouă provocare pentru tinerii și viitorii auditori financiari” în revista Audit Financiar nr. 138/2016. Articolul a avut cele mai multe descărcări din sistemul CrossRef.

## Awards of the Journal “Audit Financiar”, 2016

In November, the editorial office of the journal “Audit Financiar” granted the awards to the authors of the articles published in 2016.

**The special award of excellence** was granted to professor Liliana Feleagă from Bucharest University of Economic Studies. The prize was offered for the continuous support of the journal through the published articles, reviews conducted, the promotion of the publication in the academic environment.

**The award of excellence “Constantin Ionete”** was granted to the associate professor Ionela-Corina Chersan from the “Alexandru Ioan Cuza” University, Iași, Romania, for the paper “Internal audit practices and trends in Romania and worldwide.” The paper was published in the journal Audit Financiar issue 141/2016 and approaches an interesting theme for the members of the Chamber of Financial Auditors in Romania. This was the most downloaded article from the journal's webpage ever since it was published.

The award of excellence “Alexandru Rusovici” was granted to the doctoral student Sînziana-Maria Rîndașu from the Bucharest University of Economic Studies for the publication of the article “Information security – a new challenge for the young and future financial auditors” in the journal “Audit Financiar” issue 138/2016. The article was the most downloaded in the CrossRef system.

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# Accounting standards that appeal to the professional judgment: a threat or an opportunity for the accounting profession?

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## Abstract

*The international accounting standards (IFRSs and ISAs) rely increasingly more on the "professional judgment". What is the situation in France and in Romania? After the conceptual clarifications, the article places the evolution of the professional judgment in the general movement of the law, which goes from "modernism" to "post-modernism" to become a law of specialists able to have a qualified opinion on highly technical subjects.*

*In order to observe, in a scientific manner, this evolution of the accounting standards, we conducted a content analysis of principal legislative accounting texts, international and national (France and Romania), supplemented by a lexicometric analysis. These analyses allowed us to conclude that the importance of professional judgment in accounting standards is lower at the national level than it is at the international level. However, we highlight a number of dangers related to an increased use of professional judgment: loss of comparability and transparency, increased risks for accounting professionals including auditors, and significant discrepancies in the use of professional judgment in individual or consolidated accounts.*

**Keywords:** Professional judgment, accounting standards, accounting law, modern law, postmodern law.

**JEL Classification:** M41

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## Introduction

Let us compare two statements:

“Any natural person or legal entity as a business **has to** book the transactions affecting his business and its assets” (translation, French Commercial Code, art. 123-12).

and

“The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.” (IFRS, Conceptual framework, art. 1.2).

We notice that we are in two different worlds that convey two opposite concepts of the law. The first, whose strong legitimacy is conferred by its source, the Parliament’s vote, should not justify its choices. The second, whose legitimacy can be challenged<sup>1</sup> is justified by indicating its usefulness. The latter being perfectly subjective, it should designate an authority whose **professional judgment** will allow the decision-making process. Of course, in the international accounting standards ecosystem, this authority is represented by the “*professional accountant*”. His intervention will be even more decisive, as the IASC/IASB has opted clearly for principles-based standards that must be interpreted, as opposed to rules-based accounting standards.

France is now in the middle of a bridge. On the one hand, it has a long tradition of rules-based standards with the successive general accounting standards based on a general chart of accounts and many adaptations for the different branches. On the other hand, France, as well as all other European countries, uses the IFRSs for the consolidated accounts. Between these two approaches, there are the European directives. This “hybrid” accounting law calls more than ever for professionals to exercise their professional judgment, which on the one hand contributes to emphasize their value, but on the other hand, may also be a risk factor.

In Romania, the Parliament adopted the Accounting Law on December 24, 1991 (Monitorul oficial, December 27<sup>th</sup>, 1991). This law (art. 4) designates the Ministry of Finance as the main standard-setting body that also provides the templates for the annual financial

statements. It is largely inspired by the French law. “Since 2000, Romania has introduced an obligation to apply international accounting standards of the IASB to attract foreign investors and thus to promote openness and transition to a market economy; business scope covered by the obligation to apply IAS-IFRS expanded every year until 2005.” (Khouatra, 2004, p. 29)

In the following, based on the accounting and auditing standards, we propose:

- To clarify the concept of professional judgment;
- To identify the tension between the two concepts of accounting standards in a broader legal context;
- To indicate specifically that the choice of words in different accounting standards illustrates the conflict between the two logics.

## 1. The concept of professional judgment

Even though we make judgments every day, it is difficult to define this concept. Different disciplines use it, such as philosophy, law, psychology, psychoanalysis, theology, etc. It may take several qualifiers: value judgments, the judgment of taste, professional judgment, ethical judgments, etc. In our context, we retain the following definition of judgement: “Operation which consists in forming an opinion, in case a precise understanding cannot be reached” (translation, Lalande, 1983, p. 548).

More specifically, the “professional judgment” can be defined as: “The ability of a member of a profession of judging a situation without knowing all the necessary elements with certainty and to choose the acceptable action path if professional standards allow such decision. (...) The exercise of professional judgment requires the profession’s member an objective and prudent analysis, based on experience and knowledge (including knowledge of their own limits) thereof and a sense of responsibility towards those who may suffer the consequences.” (translation, Ménard et al., 2004, p. 931).

In the centre of these two definitions lies uncertainty. Indeed, a professional accountant should make predictions (for example, to calculate the present value of future cash flows), to translate a series of intentions (for example, to classify securities as financial

<sup>1</sup> See also: Burlaud and Colasse (2011).

investments or trading securities) and to assess risks (for example, the estimation of a provision), that is, to give a simplified and yet “faithful” image of a reality that he knows only in an incomplete and uncertain form.

If uncertainty refers to the context of that action, this relates also to the outcome of the decision made by the decision-maker. Thus, in the judicial system, decisions are never perfectly predictable and therefore usually there is an appeal procedure. But if there is some personal judgment, we should not confuse the personal opinion with the professional judgment. The first is freer than the second, which is based on a set of rules and standards that have been adopted by a profession (McHone, n.d., p. 3). Uncertainty is also reduced by the social pressure. “We believe that we are not masters of our assessments; that we are bound and forced. This is the public consciousness that binds us.” (translation, Durkheim, 1911, p. 6)

The evolution of the accounting standards, along with the more general developments of the law, leads to further define the principles which shall be subject to a deductive reasoning rather than to detailed rules.<sup>1</sup> These standards are relying increasingly more on the professional judgment<sup>2</sup>. This is one of the characteristics of postmodern law.

## 2. Towards a postmodern state: standard over law

Making sense of history raises two major problems:

- Defining the historical periods, by their beginning and their end, reminiscent of the division of time in accounting exercises;
- Qualifying events by defining their features, which the accounting standard-setter should do, as well.

The recent developments in the law in all its branches that occurred after the industrial revolution, including the accounting law, include, after Chevallier (2014), two major periods:

- “Modern” state and law from the 19th century until the 1970-80s;

<sup>1</sup> See also: Lakovic and Puglister (2013).

<sup>2</sup> Sir David Tweedie, at that moment President of the IASB, declared on October 24<sup>th</sup>, 2007 in the Subcommittee on Securities, Insurance and Investments of the United States Senate: “A principles-based standard relies on judgements”.

- “Postmodern” state and law since the 1970-80s until today.

### 2.1. “Modernism”

Modernism or modernity are characterized by technical (science and technology development), economic (the concentration of the means of production) and administrative features (the development of “invisible technologies” by the development of bureaucracies) (Chevallier, 2014, p. 12). The cult of Reason replaces the obedience to Gods (laicization). Only the State is responsible for “making a subtle compromise between the primacy of the individual and the need to create a collective order.” (translation, Chevallier, 2014, p. 12). It “is based on Aristotelian logic (applicable solutions where specifications are deducted from the general rules” (translation, Chevallier, 2014, p. 101). Due to the uniqueness of the law source, the State, one can also speak about the “Jupiterian law” or the monistic conception of law.

The accounting law is subject to that logic, especially in France, related to the different general accounting standards issued starting with 1947. The same situation is registered in Romania starting with the accounting law issued in 1991. The State is the sole arbiter of conflicts between private interests expressed within the institution responsible for standards setting<sup>3</sup>, the only guarantor of the public interest. Accounting standards, in this view, must leave a minimum room for professional judgment, based on the assumption that it can disrupt this balance which does not legitimately favour any particular stakeholder.

### 2.2. “Postmodernism”

Postmodernism was born of globalization conducted between the 1970s and the 1980s, which was not a simple development of international trade, as it disturbed profoundly the equilibrium inherited from the Industrial Revolution. It is characterized by the fact that the State had to take into account increasing complexity, confusion, imprecision and uncertainty (Chevallier, 2014, p. 15). Individualism creates instead a “hyper-individualism” with social networks and the decline of intermediate bodies such as trade unions, political parties, etc. A global civil society, a poorly defined

<sup>3</sup> See also: Bernard Colasse (ed.) (2009, p. 1109) and Colasse and Lesage (2007, p. 113).

“international community” conquers media space in all the States. Globalization has greatly limited statehood. For example, “a third of the laws adopted by the French Parliament were transposing European directives and most of these authorized the ratification of international treaties” (translation, Chevallier, 2014, p. 110).

The law did not escape without being affected. Increased complexity and technicality of the texts delight lobbies and experts’ communities’ networks. This means more to regulate, rather than legislate. The state is simply an arbitrator of a game whose control was largely lost. The result leads to “weak”, slim, pragmatic, flexible laws. We are moving away from a natural, and thus universal legislative system. A contingent and opportunistic law becomes the ideal type, legitimized by the idea that from the technical point of view it would be more successful because it comes from professionals, and would be more democratic because it comes from down to top. Furthermore, the development of arbitration in conflicts resolution limits the role of the State in the execution of arbitral decisions to the extent that States have (yet?) the monopoly of coercion. In addition, arbitration is institutionalized by creating the Permanent Court of Arbitration, for example. But the “court of the public opinion”, in turn, could compete with the States’ power to sanction, by weighing the companies with an associated reputational risk, which can sometimes be a more effective solution, even it is not well-framed. The recent Volkswagen example reminds us of it, just as the Arthur Andersen case is still remembered within the accounting profession. The power of opinion is based on the media, except for the case in which the media is based on an opinion, as evidenced, in particular, by the *Panama Papers*. But the opinion is also based on social networks, on the expertise of institutions such as rating, certification, or qualification agencies, etc. and civil society organizations such as Greenpeace or, in our field, Transparency International, Finance Watch, etc.

Accounting standards are a good example of this new “globalization law”, built at the initiative of economic operators (Chevallier, 2014, p. 125), the IASB in this case, which still needs an European regulation (Regulation No. 99-02 of 29 April 1999 on consolidated accounts of Commercial companies and public interest entities) to give it the “force of law”. Moreover, the globalization of law is not only a territorial matter, but also a matter of content. Thus, the global accounting standards, the IFRSs, cannot refer to concepts derived

from national laws (the notion of “patrimony” that comes from the Civil Code, for example) or tax laws. By becoming global, accounting standards become autonomous.

Produced widely by the professionals, applied by the professionals, inaccessible to the public because of the technical nature of the topics, and autonomous, it is logical that these international standards allow the use of professional judgment in the process of implementation and interpretation. Thus, moving from a prescriptive law with a long tradition (“Thou shalt not kill”) towards an interpretative law (the professional’s quest for “relevant”, “useful” or “adapted” solutions). In addition, the professional judgment allows to adapt the international standards to local circumstances, to form a necessary “*glocalization*” (globalization + localization).

Therefore, we see that a form of legal self-management, self-regulation, self-discipline (ethical behaviour) develops under the guidance of professional organizations that cooperate with the States, but are dominant in technical matters. Sovereignty is shared, “which involves a contradiction in terms” (Frydman, 2000, p. 71).

The postmodern law is also a fragmented law, as it can be seen from the multitude of issued codes. In France, today, there are more than fifty codes (Chevallier, 2014, p. 152): urban development, education, roads, health, environment, forestry, rural, etc. It is in fact a specialists’ law, designed for professionals able to have an opinion on highly technical subjects.

### 3. Towards an accounting law that appeals to the professional judgment?

While national or international accounting laws and standards almost do not use the term “professional judgment”, we will see that the concept is still very present through expressions that are veritable markers. This diversionary use justifies some methodological details.

#### 3.1. Methodology

It is not possible to achieve a lexicometric research on the “whole” accounting law. We limited the search to six texts for the purposes of this exploratory work:

- Four texts dealing with accounting and financial reporting:
  - The Conceptual framework of IFRS (exposure draft disclosed in 2015);
  - The “Accounting” Directive issued by the European Commission in 2013;
  - The French General Accounting Standards (PCG) updated in 2014;
  - The Romanian Order no. 1802/2014; and
- Two texts which deal with the statutory audit of the annual financial statements:
  - The Conceptual framework of the ISAs;
  - The European “Audit” Directive issued in 2014.

We have not used in our research all the IFRSs or ISAs as we did not have a single file, comprehensive of these standards in MSWord format. Therefore, to achieve the goal of our study, we retained only the conceptual frameworks on the assumption that they would be representative for all standards. Therefore, we achieved only a comparison of some texts that are roughly similar.

We chose the English version of the European Directives, but for the French standards, we conducted a search using the translation of the keywords suggested by Ménard et al. (2004). For the Romanian order, the translations were made by the authors of this article.

A first reading of these documents allowed us to identify 40 words expressing that the accountant has resorted to the professional judgment. This last term was never used. But the need to use the professional judgment derived from other wordings. For example, the word “relevance” requires a human intervention to determine the relevance of a solution in order to make a decision. Thus, article 2.4 of the IFRS Conceptual Framework states: “If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent.” Therefore, the expert must decide what is relevant, for whom and from what point of view.

For each of the 40 words or derivatives thereof (e.g., *relevant* or *relevance* are treated as a single “word”), we measured the frequency of their use in various documents. Thus, the word *relevant* and its derivatives are used 95 times in the IFRS Conceptual Framework.

We also calculated the frequency relative to the total number of words of the document, in order to compare the likelihood of occurrence in texts of different lengths. Therefore, the word “*relevant*” is used 3.6 times for every 1,000 words of the IFRS Conceptual Framework, as opposed to 0.6 times in the European Accounting Directive.

Clearly, the importance of a word cannot necessarily be proportional with its frequency. However, there is little doubt that a word with a fairly high occurrence is important. This cannot be just a coincidence.

### 3.2. Statistics regarding the elements that indicate the use of professional judgment

For each of these texts, out of the 40 words, we isolated the ten words most frequently used in order to reduce the data presented in **Table 1** and **Table 2**. We conducted a separation of accounting and auditing rules to achieve a comparison of texts of a similar nature as much as possible.

Legal “modernism”, as defined above, is the result of the Roman law tradition, which is based on the legitimacy of the law’s origins, its source. Thus, the French accounting law<sup>1</sup> was adopted by the Parliament, namely a national representation. The interpretation of law falls on the courts that decide “on behalf of the people.” Therefore, the French law leaves little space for the professional judgment in accounting. It makes sense that words such as *relevant*, *useful*, *estimate*, etc., which require some clarifications in relation to whom or what, can be found with difficulty in the French accounting standards. The Romanian Order, whose source of origin is influenced by the tradition of the French accounting laws, no longer uses some words that are absent from the French accounting standards, such as “*fair*” or “*transparent*”. The word “*relevant*” is used only once. These are all the common points between these two national accounting standards. However, unlike the French accounting standards, the Romanian order uses often the word “*estimate*” (45 times). This is due to the position of accounting in the Romanian management culture; it plays a key role as a source for information.

<sup>1</sup> The law from 30<sup>th</sup> of April 1983 integrated in the French Commercial Code.

**Table 1. The frequency of words that indicate the use of the professional judgment in the accounting laws and standards**

Conceptual framework IFRS 2015		European Accounting Directive issued in 2013		French standards issued in 2014		Romanian Order issued in 2014	
Words	Frequency to 1,000 words	Words	Frequency to 1,000 words	Words	Frequency to 1,000 words	Words	Frequency to 1,000 words
Relevant	3.557	Fair	1.274	Assessment <sup>1</sup>	3.103	Assessment <sup>2</sup>	3.841
Estimate	3.033	Material	0.849	Necessary	0.703	Material	0.812
Useful	2.621	Necessary	0.751	Probability	0.524	Necessary	0.569
Faithful	2.546	Appropriate	0.718	Decision	0.345	Estimate	0.377
Certainty	1.797	Relevant	0.621	Reliable	0.290	Public interest	0.192
Fair	1.610	Consistent	0.457	Error	0.234	Comparable	0.117
Assessment	1.573	Significant	0.392	Significant	0.221	Faithful	0.109
Necessary	1.348	Comparable	0.327	Appropriate	0.179	Accurate	0.100
Comparable	1.123	Assessment	0.294	Sufficient	0.152	Useful	0.100
Decision	1.123	Substantial	0.261	Comparable	0.138	Appropriate <sup>3</sup>	0.092

<sup>1</sup> In the French accounting standards, the fact that the term "assessment" is cited often comes from the simple fact that it has a double meaning: assessment purposes to determine a value (for example, assessing an asset; in English: appraisal or valuation) and evaluate sense to use a critical judgment on a situation (for example, to evaluate the possibility of going concern; in English: evaluation). For the French accounting standards, the number of occurrences of the word "assessment" is not necessarily significant.

<sup>2</sup> The above footnote applies also to Romania.

<sup>3</sup> In the column associated to the Romanian order, two words are found positioned in 10th place *ex aequo* with 11 appearances: «adequate» and «sufficient». Arbitrarily, we've retained only the first because we were limited to just 10 words.

Source: Author's processing.

Legal "postmodernism", by contrast, puts a strong emphasis on the professional judgment or the experts' reasoning. Thus, the IFRS Conceptual Framework uses the term "relevant" 3.6 times for each 1,000 words. The European Directive, which introduced in the continental accounting law the concept of true and fair view, is largely based on general principles (*principles-based*) and also uses words such as fair, significant, necessary, appropriate, and relevant.

The use of these words has, undoubtedly, a rhetorical function. Is it really necessary to specify that the information produced should be relevant or useful? Can you imagine an opposite objective? Certainly, the IFRS Conceptual Framework states that "The objective of general purpose financial reporting is to provide financial information about the reporting entity that is **useful** to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity." (IFRS Conceptual Framework, art. 1.2) Of course, the IASB specifies implicitly what is "useful", by producing a set of standards. However, the idea expressed here is not the same as that which asserts that the financial statements should be compliant, or in accordance with written rules.

It is also interesting to note which words are never used. Thus, one of the major properties of accounting is to ensure the traceability of financial flows and, therefore, contribute to **transparency**, without which there can be no trust. Trust is the society's as well as the business world's cement. The word itself, "transparency", is never used. Indeed, curiously, the IASB Foundation's "Constitution", the IFRS's Conceptual Framework, the 2013 European Directive on the annual financial statements, the French accounting standards in 2014 or the Romanian order do not use this word. The IFAC's Constitution does not make any reference to it, either. This is even more surprising, since transparency requires a common language to ensure that the information is produced and then interpreted by different users accordingly. It is no longer mentioned by the IFAC's code of ethics, or the two French Professional Accountancy Bodies<sup>1</sup> or other professional bodies in

<sup>1</sup> The two professional bodies in France are: Compagnie nationale des commissaires aux comptes (CNCC; auditors) and Ordre des experts-comptables (OEC; accountants in public practice). Their equivalent in Romania are: Camera Auditorilor Financiari din România (CAFR) and Corpul Experților Contabili și Contabililor Autorizați din România (CECCAR).

their own codes. Opposite to opacity, transparency is still one of the conditions of existence of a state subject to the rule of law. This does not mean that everything should be known by everybody. There are, of course, “access rights”, such as computer programmers say, variables without which there would be no privacy or trade secret. The secret may be necessary and cannot cover embezzlement. Transparency can be “intermediated”, that is to say achieved through a third party. Thus, the auditor has access to all of his client’s records, useful for carrying out the engagement and third parties know through him that these records do not include elements which constitute or reveal criminal acts. We must add the fact that access rights are not transferable. Thus, some recipients of the information should also be discrete (for example, the elected members of the Works councils) or professional secrecy (for example, the auditor or the chartered accountant). If the need for transparency is universal, the degree of responsibility of one depends on the degree of access to information (the secret is not protected everywhere in the same way as shown, for example, by the bank secrecy whose definition varies from one country to another), or it depends on the established balance between (i) transparency, that allows the exercise of social control and (ii) business secrets, that can neutralize any potential hostile actions. This balance relies largely on the exercise of professional judgment.

The **public interest** is the central argument of the legitimacy of the legislature or of the standard-setter, which is somehow a legislator by delegation. This concept has a great evocative power. Thus, the “Constitution” of the IFRS Foundation uses the phrase “public interest” eight times in 19 pages, and that of the IFAC, 28 times in 17 pages.

None of the two standard-setters define the public interest; they provide only an institutional response in terms of governance.

For the IFRS Foundation, the 22 Trustees are committed to act in the public interest (Constitution, art. 6). It also states that:

- “The mix of Trustees shall broadly reflect the world’s capital markets and diversity of geographical and professional backgrounds.” (art. 6)
- “The Trustees shall comprise individuals that, as a group, provide an appropriate balance of professional backgrounds, including auditors, preparers, users, academics, and officials serving the public interest. Normally, two of the Trustees

shall be senior partners of prominent international accounting firms. To achieve such a balance, Trustees should be selected after consultation with national and international organizations of auditors (including the International Federation of Accountants), preparers, users and academics.” (art. 7)

This highlights that, for the IASB, the public interest is confined to the interests of financial markets and that the *Trustees* are mostly professionals appointed by professionals.

For the IFAC, the “Constitution” provides a “Public interest oversight authority”, without further clarifications.

These institutional responses illustrate the difficulty to define the public interest. Gathering people whose technical competencies and integrity are not questioned, is not sufficient to ensure a good representation of the public interest.<sup>1</sup>

By its nature, public interest is an unclear and contingent concept. It has a deeply political character. Instead of being defined, is this concept introduced into the standards? The IFRS Conceptual Framework does not mention it either. The same thing is true for the Accounting Directive 2013 and the French accounting law and standards. The Romanian Order from 2014 does not mention the public interest. It recognizes the public interest with regard to public interest entities (PIE), that is to say that they are of interest for the public, but it is irrelevant to the public interest or general interest. In none of these documents, the general interest found an operational tool or contributed to the universality of the standards.

The choice of words and the frequency of their use are an indicator of a certain conception of the laws in general and of the accounting law, in particular: a law of and for the experts. Let’s see now the laws and standards related to the financial audit.

The comparison of the texts governing the auditors’ professional practice is more complicated because the texts are not of the same nature. There should be compared all the International Standards on Auditing (ISA) with those from France, Professional Standards (*Normes d’exercice professionnel*; NEP) of the Statutory Auditors and the Romanian equivalent, which was quite difficult, given the amount of information that had to be processed.

<sup>1</sup> For this subject see also Burlaud and Colasse (2011, p. 119).

**Table 2. The frequency of words that indicate the use of professional judgment in the financial audit law and standards**

IAASB Conceptual Framework, 2005		The Audit Directive, 2014	
Words	Frequency to 1,000 words	Words	Frequency to 1,000 words
Appropriate	5.852	Appropriate	2.264
Material	4.835	Relevant	1.932
Reasonable	4.326	Decision	1.049
Sufficient	2.926	Effective	0.939
Relevant	2.672	Assessment	0.939
Reliable	2.163	Necessary	0.883
Effective	2.036	Sufficient	0.552
Assessment	1.399	Transparent	0.442
Judgement	0.891	Significant	0.331
Consistent	0.891	Fair	0.331
Significant	0.763	Material	0.276

Source: Authors' processing.

Despite these limitations, it is revealing to see how the ISAs use the following words: adequate, meaningful, reasonable, sufficient, relevant etc. These words require the professional judgment. The European Directive uses the same words, but with a systematically lower relative frequency. The Anglo-Saxon influence has been definitely mitigated by other European countries' legal tradition.

## Conclusions

On the edge of a postmodern accounting standardization, the IASB promotes, on the one hand, transparency and comparability and, on the other hand, the relevance to support investors' decision-making processes (IFRS Conceptual Framework, art. 2.a). However, there may be a conflict between these two objectives.

The use of professional judgment does not contribute to transparency. Indeed, the choices made by those who prepare the financial statements and the auditors are documented in short, either in the notes to the financial statements or in the audit report. They often use standard formulas, which have a rhetorical purpose, such as: "appropriate solutions", "according with the practice of the profession", "reasonable assurance", etc. In addition, the professional judgment is subjective by definition, and can lead to different responses to the same questions. Then, what about comparability? The areas of interpretation should be reduced and standards with detailed rules should be issued (*rules-based*).

Moreover, mentioning the public interest and relevance of financial reporting for investors, the assertion of

substance over form, principles-based standards, extends the use of professional judgment beyond what is necessary for the implementation of the old traditional rules that ensured conservatism<sup>1</sup>. We can see the paradox of using the professional judgment, a recourse that we have demonstrated with the lexicometric study, which penalizes transparency and comparability for the benefit of relevance, a concept which is difficult to define.

Is this fundamental evolution of the accounting standards, moving from the stage of "Jupiterian" (or "royal") law to a law that is co-produced with the professionals, by and for the experts, outside the national representation, a threat or an opportunity for the accounting profession?

This is indisputably a threat for the public interest, represented in the process of issuing the accounting standards only by pressure groups which are not legitimate to represent it, as long as other stakeholders are absent. Thus, counter-powers are necessary. Will the EFRAG reach the expectations?

From the accounting profession's point of view, the broad use of professional judgment in the production and auditing of financial information is beneficial. This is an opportunity. Professional expertise is a key element. But according to the principle that profitability increases along

<sup>1</sup> This rule that almost disappeared from the IFRS Conceptual Framework is evoked only in art. 2.18, but it is associated with neutrality, in order to not undervalue the net assets in a systematic manner.

with the associated risks, professional accountants witness a due care evolve into the obligation to achieve a result. Compliance with the standards is a mean, relevance is a result<sup>1</sup>. In this case, it is a threat.

This evolution of the accounting law leaves us today in the middle of a bridge with a “hybrid” law: it still

relies on the reputation of the past, especially in the individual financial statements, and has a possible future, less predictable, especially in the consolidated financial statements. But one should not confuse change and progress. Nothing is decided yet.

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# The adoption of integrated reporting principles by the Romanian companies listed at the Bucharest Stock Exchange

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## Abstract

*This paper aims to identify a company with Romanian capital that has potential to implement the integrated reporting principles, with real benefits in attracting investors and/or building an international reputation. To achieve this goal, we performed a study on companies listed at the Bucharest Stock Exchange that operate in different sectors. We analysed the investment opportunity, the reports published currently by the companies and their compliance with the International Integrated Reporting Framework in the view of preparing an integrated report. The case study revealed a high potential for the implementation of integrated reporting within Antibiotice Iași S.A. As compared to all the selected companies, this company's reporting practices are currently the most similar to the integrated reporting. However, for the other companies, the option to publish an integrated report is viable under certain conditions, particularly in order to build a business card that is internationally recognized and universally comparable.*

**Keywords:** *Integrated reporting, Romania, value creation, listed companies.*

**JEL Classification:** *M14, M41*

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## Introduction

The “Integrated Reporting” concept fits the modern vision of a performant entity, a vision that goes beyond the economic sphere. Thus, a company reinforces its market brand if it is involved in actions related to environmental protection and societal development. The relevance of an integrated report comes from how the description of the value creation process for all stakeholders really leads to attracting investors and shapes a clearer and more comprehensive image for any user of this mix of financial and non-financial information.

In 2010, the International Integrated Reporting Council (IIRC) was founded in order to create an international framework of integrated reporting. Thereby, it brought a contribution to the development of a new type of reporting that shows in a unique, concise and comparable format the aspects linked to the past or future impacts or an entity’s performance (IIRC, 2010). In the next year, the organization started a pilot programme that had an important role in the development of the integrated reporting framework, an approach that led to the involvement of over 100 entities worldwide (IIRC, 2011).

Integrated reporting is concerned with the process of creating value for all stakeholders over the medium and long-term, through a mixed approach or, more specifically, through one report accessible to all stakeholders that shows how social and environmental performance and good governance contribute to a higher financial performance (Eccles and Serafeim, 2011). The concept of integrated reporting as defined by the IIRC in the International Integrated Reporting Framework (IIRF) proposes the creation of integrated thinking within an entity, directing the disclosures towards its true development power. Moreover, the idea of integrated reporting is not related to the reporting itself, but to the appropriate communication of a company’s responsible behaviour (Almond, 2015). It can also be considered that integrated reporting is a marketing tool. An entity which chooses such reports shows an additional involvement that increases the investors’ interest and guarantees the reading of the report (Giuclea, 2013).

In addition to a holistic approach of the business and the satisfaction of investors’ informational needs through environmental, social performance and governance, the

literature has found that integrated also reporting brings internal benefits such as a lower reputational risk and a better allocation of resources and worldwide regulatory benefits, building a universally accepted language that facilitates the comparison of the communicated information (Eccles and Saltzman, 2011).

The communication of non-financial aspects was voluntary for the large European companies until the adoption of the Directive 95/2014/UE, applicable from 1<sup>st</sup> January 2017. More specifically, large public interest entities with over 500 employees are required to add a nonfinancial declaration to the board’s report or to publish a separate report describing the business model and the environmental, social and personal policies, human rights, combating corruption and bribery, as well as the analysis of the results and risks associated to these policies. This regulation comes to make the companies in Europe, Romania included, aware of the importance of maintaining a communication that is adequate in relation to all the stakeholders’ interests and informational needs.

In fact, integrated reporting is a practice based on achieving harmony between the world of the financial statements and the one of the sustainability reports (Van Bommel, 2014). Most large companies already publish sustainability reports. Given the fact that 49% of entities that publish integrated reports in compliance with the IIRF are from Europe (Chersan, 2015), this directive represents the first impulse to the implementation of this practice in more companies, including the ones with Romanian capital that operate in Romania.

The IASB conceptual framework places the investors and the creditors at the top of the information users’ classification, with the argument that their informational needs are similar and cover the interests of all other categories. Furthermore, the users cannot require directly the disclosure of the information, being forced to rely on the reports published by the companies (Dima and Șărămăt, 2011). Thus, although the information presented in the financial statements are useful to all users, the presentation focused on the investors’ and creditors’ informational needs is privileged, a fact from which we can deduce the importance granted to the financial markets around the world (Ristea, Olimid and Calu, 2006).

Therefore, apart from the idea of creating value, integrated reporting becomes a bridge between the companies and the capital markets. It facilitates the

understanding of their business strategy and how they obtain performance and create value (KPMG, 2011).

The 2015 integrated report of the IIRC mentions that 71% of the investors consider that integrated reports are important for the decision-making process (IIRC, 2016). However, the factors that affect the investment decision in a company are not limited to the company's reporting, but also to the sector's attractiveness or even to the investor's personality. Understanding the sector in which companies operate and the associated risks allows the companies to improve their non-financial reporting practices, which ultimately leads to greater transparency on the capital markets (Eccles et. al., 2012).

The company should be the first to benefit from all the costs involved in the preparation of an integrated report: compliance with the IIRF, with the requirements of all interested parties, continuous innovation, the amount of work and time devoted by the people who participate at the preparation of the report. Thus, we consider that a company's listing on the stock exchange does not only mean obtaining financial resources (for the business) and dividends (for investors), but it also involves a different type of connection to the international environment, greater comparability of the published information, and even a positioning among the largest companies in the world, which is why the company should be more motivated to publish higher quality reports.

According to the IIRF, an integrated report presents the value creation process along with the contribution to this process of all the capitals (financial, manufactured, natural, human, social and relationship, intellectual), in such way as to comply with the seven integrated reporting guiding principles: strategic focus and future orientation, connectivity of information, stakeholder relationships, materiality, conciseness, reliability and completeness, consistency and comparability.

The objective of this paper is to identify the potential of listed companies in Romania to adopt integrated reporting and the benefits that come with this decision. To this end, we performed a case study type analysis of Romanian companies listed at Bucharest Stock Exchange (BSE).

The importance of this research lies in the fact that integrated reporting is a relatively new practice and almost non-existent within Romanian companies. Romania can become a favourable place for the implementation of integrated reporting through the companies listed at BSE, which already have an image and a market of interest for the different categories of users.

The paper is structured as follows: the second section represents the research methodology. The third section briefly presents the selected companies and the industry in which they operate. Section four includes the study of the reports published currently by the selected companies. Section five examines the entities in terms of their potential to adopt integrated reporting. The last part includes the conclusions and limitations of the study, as well as future research opportunities.

## **1. Research methodology**

The objectives of this paper are (i) to analyse the potential of Romanian companies listed at BSE to adopt integrated reporting and (ii) to identify some possible benefits arising from this decision.

To achieve this goal, we realized a case study regarding the Romanian companies listed at the BSE. There were selected 12 companies from different industries, all having Romanian capital. The selection process consisted of choosing, from the components of the BetPlus index, the companies with Romanian capital and with an average number over 500 employees. To calculate the percentage of Romanian capital, the value of the field *others* from the subcategory *Shareholders' structure* on the *Summary* page of each company available on the BSE website was not considered.

We analysed the industry in which the selected companies operate in terms of the impact of the decision to invest in such companies. We studied the reports and the information published currently by these companies, and then we determined which company has the potential to adopt integrated reporting and any related benefits based on a qualitative research.

More specifically, this study aimed to find answers to the following questions:

- Does integrated reporting help to attract investors?
- To what extent do the characteristics (attractiveness) of the sector determine a company to adopt a superior form of reporting?
- Does integrated reporting allow companies to become international?

This research is important for auditors too, because the need to present non-financial information brings with it the need to verify their credibility and the assurance of integrated reports is performed by auditors (Dumitru and Gușe, 2016).

## 2. Listed companies at the Bucharest stock exchange

This research is based on the study of reports and information published by the selected companies on their own website. In the BetPlus index there are included 28 companies, but only 18 of them have a majority of Romanian capital. 12 out of the 18 companies have an average number of over 500 employees. Thus, the characteristics of the 12 companies listed at BSE that were selected for this study are presented in Table 1.

**Table 1. Companies with Romanian capital listed at the BSE**

No.	Company	Sector	Romanian capital	Number of employees
1	Aerostar	Industrial (aircraft and spacecraft)	86,17%	1.600
2	Antibiotice	Pharmaceutical	66,57%	1.465
3	Artego	Industrial (rubber products)	84,82%	1.176
4	Compa	Industrial (auto parts and accessories)	54,60%	1.660
5	Conpet	Services (pipeline transport)	58,72%	1.709
6	Electromagnetica	Industrial (instruments and devices for measuring, testing, control and navigation)	54,90%	626
7	Nuclearelectrica	Utilities (electricity)	82,50%	2.051
8	Oil Terminal	Services (manipulations)	59,62%	1.016
9	Romgaz	Utilities (natural gases)	70,01%	6.233
10	Transelectrica	Utilities (electricity)	58,69%	2.180
11	Transgaz	Utilities (natural gases)	58,51%	4.854
12	Vrancart	Industrial (paper, paperboard and paper packaging)	74,72%	903

Source: Author's processing.

In the following, we will present the characteristics of each industry in terms of the investment opportunity in a company that operates in a specific industry.

The **pharmaceutical sector** is characterized by an inelastic demand, the consumption of pharmaceuticals being independent of changes in its price, regardless of the stage of the economic cycle. In the context of aging population and declining birth rates (INS, 2015), in Romania it occurs an increase of the demand for pharmaceutical treatments (Cealera, 2014). This situation leads to the allocation of a larger proportion of the consumers and State's financial resources to this type of expenditure and, thereby, to the increase of the manufacturing companies' earnings, with a direct and positive effect on the market price of their securities.

Also, the demand in this sector is atypical, most of the pharmaceuticals being offered under prescription. Therefore, the decision factor is the medical professional who prescribed it or the pharmacist, and the treatments are usually covered by the national system of health insurance (European Commission, 2009). Thus, this sector has a long cash conversion cycle due to the delay in refunds and repayments in the health insurance system. This can become a problem through the increase of the debt ratio caused by the lack of liquidity and can lead, on the long term, to the insolvency of the producers or distributors of pharmaceutical products. Therefore, the pharmaceutical sector presents favourable investment perspectives because it is characterized by a low risk, being one of the best regulated industries in the world (IPE, 2011).

The public utilities sector is also an area characterized by an inelastic demand because consumers will continue to require utilities, regardless of their price. It is a sector with an oligopoly type of competition, with only few companies providing such services in Romania. In theory, the prices are formed freely, based on supply and demand, but in practice they are dictated by international political and economic circumstances and the interests of natural gases and electricity suppliers. In addition, the price of natural gases is closely connected to the evolution of the oil price; the recent dynamics of the oil price has also influenced the price of the natural gases. The investment in this sector is considered to be favourable because natural gases are the most used energy resource<sup>1</sup> and Romania has the largest market of natural gases in Central and Eastern Europe<sup>2</sup>. However, it should be taken into account the seasonality of natural gases consumption, with a maximum in the cold season and a minimum in the warm season.

Regarding the Romanian industrial sector, the latest available Statistic bulletin of industry states that industrial production increased by 5.3% in August 2016 as compared to August 2015. Among other reasons, this variation was due to an increase of 23.9% of the motor vehicles, trailers and semi-trailers manufacturing, an increase of 27.1% of the electrical equipment production, a reduction of 16.8% of activity in the field of machines and equipment's repairing, maintenance and installation and an increase of 12.7% of the paper and paper products manufacturing (INS, 2016).

It can be observed that most of the companies selected for this study operate in the industry or the public utilities sectors. We believe that their listing on the BSE is an asset and another reason for which it may be considered that the option for a superior form of reporting signals an additional involvement, therefore a redefinition of the already achieved successful image.

As examples of benefits derived from the implementation of integrated reporting we can mention: attracting new investors (financial resources), strengthening consumers' confidence, contribution at the community welfare and environment protection. All these features may have an important contribution to the

choice of the products and services offered by one of these companies over others in the same sector. In the case of a potential responsible investor (concerned of non-financial aspects), integrated reporting can significantly influence its decision to invest in a listed company.

### 3. Analysis of the reports published by the companies listed on BSE

We analysed the annual reports published by each of the selected companies by consulting the documents available on the BSE's website and on each company's website. We used 2015 as a reference financial year.

Apart from the Accounting reporting in compliance with the Ministry of Public Finance Order no. 123/2016, the Budget of Income and Expenses, the Independent Auditor's Report and the financial statements prepared in accordance with the IFRS, the selected companies publish the Regulation/Code of Corporate Governance and other reports, as shown in Table 2.

The annual reports (sometimes called Annual Directors' Report or Board of Directors' Report) published by all of these companies are, in fact, drawn up in accordance with the Regulation no. 1/2006 of the National Securities Commission (Comisia Națională a Valoriilor Mobiliare – CNVM, currently the Financial Supervisory Authority). Thus, these include aspects related to the activity of the company in the last financial year (including the financial statements), social responsibility and environmental protection, risk management, perspectives of the business, information about the management of the company and its securities' market.

In addition, many companies publish on their websites some presentations addressed to the investors which contain brief information about the activity carried out in that year.

In this part of the paper, there will be presented other useful information about the content of a potential integrated report, available on the companies' websites. All entities have a separate section describing briefly the mission, vision and the set of values that form the company's business philosophy.

<sup>1</sup> [https://ro.wikipedia.org/wiki/Industria\\_energetic%C4%83\\_%C3%AEn\\_Rom%C3%A2nia#Gazele\\_Naturale](https://ro.wikipedia.org/wiki/Industria_energetic%C4%83_%C3%AEn_Rom%C3%A2nia#Gazele_Naturale)

<sup>2</sup> <http://www.anre.ro/ro/gaze-naturale/informatii-de-interes-public/piata-gazelor-naturale>

**Table 2. Other reports published by the selected companies listed at BSE**

No.	Company	BSE symbol	Additional reports published
1	Aerostar	ARS	Annual report
2	Antibiotice	ATB	Annual report
3	Artego	ARTE	Board of Directors' Report
4	Compa	CMP	Annual report
5	Conpet	COTE	Annual report regarding the awarded sponsorship Quarterly report on environmental performance Directors' Report
6	Electromagnetica	ELMA	Directors' Report
7	Nuclearelectrica	SNN	Annual Report (of the Directors from 2013)
8	Oil Terminal	OIL	Annual report
9	Romgaz	SNG	Directors' Report Social Responsibility
10	Transelectrica	TEL	Annual Report Environmental Report (latest version of 2007) Impuls Journal (latest version of 2009)
11	Transgaz	TGN	Annual Directors' Report Corporate Social Responsibility (CSR) Brochure (latest revision in 2014)
12	Vrancart	VNC	Board of Directors' Annual Report

Source: Author's processing.

The annual report published by **Aerostar, Artego, Oil Terminal** and **Vrancart** are strictly aligned with the requirements of the CNVM Regulation no. 1/2006, presenting aspects related to environmental protection in the section that measures the business's impact on the environmental factors. At the same time, there are presented issues related to corporate governance, risk management and a summary of the financial results of the last year. In addition, their webpages do not contain any other non-financial information. The annual report published by Aerostar presents, in a more interactive and comparative manner, the company's plan at the beginning of the year, the results obtained during the year and future perspectives. There is a focus on sustainable development and environmental protection. Oil Terminal's annual report is composed of several reports and statements, out of which the Directors' Report gives a black and white image of the company. Vrancart publishes a brief annual report, well-structured, with an interactive format, including the impact of the company's activity on water, air and soil and the CSR actions carried out in support of the local community.

The annual report published by **Antibiotice Iași** is interactive and mixes financial concepts with progresses in the social and environmental fields. It starts with the Board's messages, business description and the

presentation of the company's strategic orientation. The bulk of the report is the description of the performance obtained in various fields during the year: actions and results of the research, the quality of the manufacturing process, investment policy, marketing policy, export policy, the relationship with interested parties, human resources policy.

In the chapter entitled *Social responsibility*, there are presented the social, educational and cultural projects in which the company is involved and their results, showing Antibiotice's involvement in the community's welfare. Examples of such CSR programs: Foundation *Antibiotics – Science and Soul, Donate blood! Save a life!, The power of action*. Environmental aspects are presented in the same chapter, in the section *Promoting environmental protection*, where the company describes its policy in relation to water quality, air pollution, energy use, soil protection and waste management. Examples of environmental programs: *Be pro nature. Involve!* and the participation at the *Earth Hour* initiative.

The company's involvement continues beyond the report, through the section *Partnerships in education* on its webpage. The company sponsors patients' treatment and medical research, showing a list with real beneficiaries. Moreover, in *News* section there are presented the A+ Summer School or the *Perform a+*

project, and in *Sport's partnerships* section, the company states that it supports the volleyball team *Penicilina*.

**Compa S.A.** includes in the annual report a brief section entitled *Social responsibility* presenting the principles and rules in this area applicable within the company and a few actions of community support. This entity does not draw up environmental or social reports, but it offers some information on its website regarding its philosophy in terms of environmental protection, human resources and social responsibility. The section *About COMPA* contains the following categories:

- *The concern and care for the environment* – the brief description of the environmental policy, quarterly briefings for the stakeholders (still in progress) or the environmental announcements for a certain period of time;
- *Social responsibility* – reference to the principles of ethics and transparency respected within the company and the results of its involvement in community life;
- *COMPA principles* – brief presentation of the company's philosophy in terms of clients, performance, law, respect of the environment and investment in people;
- *European projects* – the company has implemented European projects in order to develop the human resources, energy efficiency and to increase the competitiveness of its research and its innovation capacity.

**Conpet S.A.** publishes a quarterly report on environmental performance to briefly describe how the company's activity affects the environment (water, air, soil), the waste management policy and legislative issues regarding environmental protection. The entity also publishes a sponsorship report, offering transparency for its actions regarding the development of the local community and showing details of the sponsorships granted. Its website contains information related to social responsibility and environmental protection within the *Policies*, section where there are summarized information concerning:

- *Social responsibility* – the company provides sponsorship for cultural and artistic events, national health campaigns, sports clubs, competitions and school competitions (all detailed in the annual report on sponsorships);

- *Environmental responsibility* – development of an environmental management program, detailing the commitments for the environment and the existence of an environmental management system continuously improved (detailed in the report of the environmental performance).

**Electromagnetica** also presents on its webpage a section entitled *Social responsibility* and there are mentioned actions like *Small joys from Electromagnetica*, ecological activities and students' support activities.

**Nuclearelectrica** describes on the website its CSR actions in the section with the same name. There is presented a statement of corporate social responsibility, the projects implemented in this area (example: *Receive a tree in your family*) and the work performed to support the local community in Cernavodă.

The **Romgaz** webpage has a section entitled CSR which contains the following categories: environment, community, education, health, culture, sports and sponsorship guide. Within each one of them, the company briefly describes its policy of environmental protection, social involvement programs to which it takes part, the projects through which the entity invests in education, health system, sports and cultural events. All these issues are centralized in a report named *ROMGAZ social responsibility* available on the company's website. Examples of CSR projects: participation in Earth Hour initiative, the program *Offer a book, create a library, Cinema-edu* project, *Green Hospital* project, sponsoring cultural events in Sibiu, involvement in the sporting community.

The annual report of the company **Transelectrica** is a combination of several reports and it has a colourful and interactive content. Among these reports, lies the Report on Corporate Governance and Social Responsibility. In this report, there are also included the results of the CSR projects in which the company was involved, matters related to the employees' treatment and actions and results regarding the environmental protection.

Also, the Environmental report (last edition from 2007) is a document that improves the company's image and that is available both in Romanian and English. It describes the environmental policy, the actions and results obtained during the year. It is probable that the information contained in this report will be included, in part, in the next years' annual reports. Furthermore,

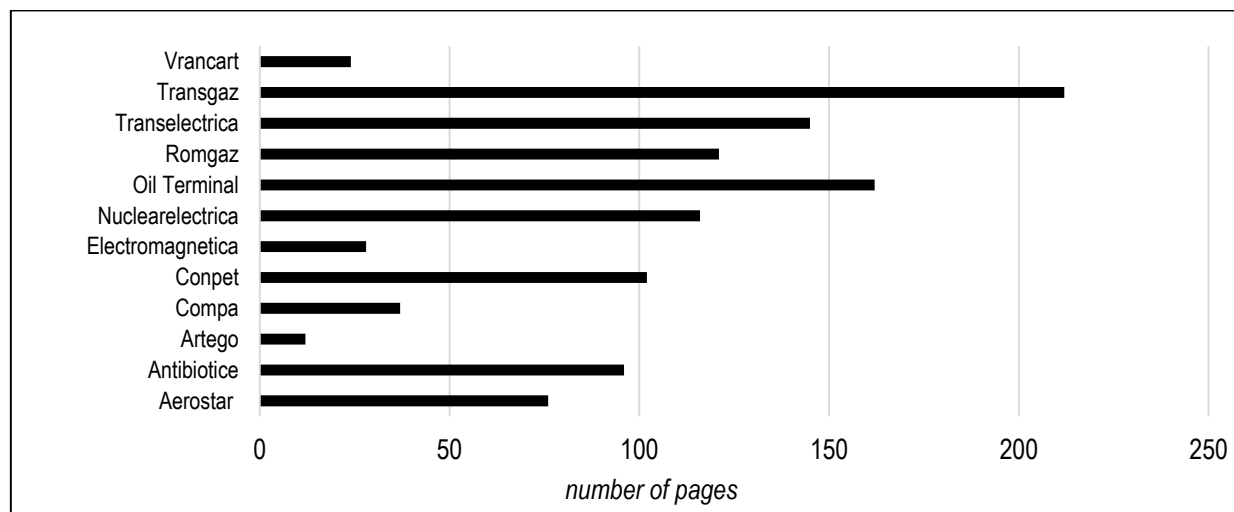
Transelectrica published, until 2009, the Impuls Journal as a statement of the main news from the field, so it also offered information related to the sector.

With regard to **Transgaz**, using the motto *A responsible company is a company of the future*, the company creates the CSR Brochure entitled *People and facts*, the last available edition being from 2014. This document summarizes the company's social responsibility and volunteering actions and the projects proposed for the future. The entity presents its philosophy regarding social responsibility and justifies the option to engage in this type of actions. CSR areas in which this company declares to operate are: community development, education, sports, arts and culture, humanitarian actions, health, environment, while the policy adopted in each one of these areas is presented briefly. Examples of CSR projects: *The green Olympics*, *We invest in the*

*future*, *Hand in hand*, *People to people*. All these programs are described in the brochure, including the results of their implementation. Other voluntary or charitable projects are: *Give a smile*; *Donating blood, you can save a life!*; *Next to you*. In addition, the company presents within the brochure the impact of these projects by disclosing the feedback received from the organizers. There are presented a series of anniversary achievements and then participants' opinions of the persons responsible for the projects are quoted. The document appears as a magazine with pictures and famous quotes, in accordance with the philosophy declared. CSR policy is detailed on the webpage, in the *CSR* section.

Therefore, like any other large company, each one of the selected entities shows its more or less intense involvement in the welfare of the society as a whole, in the most appropriate way at the time of reporting.

**Figure 1. Number of pages of the selected companies' annual reports**



Source: Author's processing.

From a structural point of view, as it can be seen in **Figure 1**, the most complex report belongs to Transgaz with over 200 pages, followed by Oil Terminal, and third, the company Transelectrica.

The average number of pages of an integrated report in 2015 was 148 pages, a decrease as compared to the previous years (EY, 2016). Analysts argue that an integrated report should be concise and, at the same

time, comprehensive. Thus, the option for 200 pages or more is not the best choice thinking that a user will get tired reading the reports of several companies at once, which would decrease the investor's interest in the companies (PwC, 2016). Therefore, the analysis will proceed with the study of the quality of these reports in terms of the image of the company they represent.

## 4. The potential to adopt integrated reporting principles

In order to determine the potential of adopting integrated reporting principles, we analysed the possibility of the these companies' reports compliance (considered as one document) with the IIRF, more specifically by observing the following requirements:

- Compliance with the seven principles of integrated reporting;
- Presentation of the business model;
- Description of all types of capitals contributing to value creation;
- Presentation of the items related to corporate governance and risk management;

- Strategy and performance obtained in the area of social activities and environmental protection;
- Business focus to sustainable development.

As noted in the third part of this paper, each one of the selected companies presents aspects related to governance due to a specific requirement resulting from their status as BSE listed companies, publishing a document for this purpose. Therefore, all companies currently have the informational resources to potentially prepare this content element of an integrated report.

Table 3 presents a summary of the compliance with the IIRF requirements for each selected company. In order to complete this table, there was considered all the information contained in the additional reports published by the selected companies and mentioned in Table 2.

**Table 3. The compliance with the IIRF of the additional reports of the selected companies**

Company	ARS	ATB	ARTE	CMP	COTE	ELMA	SNN	OIL	SNG	TEL	TGN	VNC
Requirement												
IR principles	5/7	7/7	5/7	5/7	5/7	5/7	7/7	5/7	5/7	5/7	5/7	5/7
Capitals	4/6	6/6	4/6	4/6	4/6	4/6	6/6	4/6	4/6	5/6	4/6	4/6
Business model	Yes	Yes	Yes	No	Yes	Yes	Yes	No	Yes	Yes	Yes	Yes
Sustainable development	Yes	Yes	No	No	No	No	Yes	No	Yes	Yes	No	No
Social activities	No	Yes	No	No	No	No	Yes	No	Yes	Yes	Yes	Yes
Environmental protection	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Source: Author's processing.

**Artego** and **Aerostar** are listed at the BSE since 1998; the *News* section on Artego's website provides the annual reports since 2010. On the Aerostar's webpage there are available the annual reports starting with 2012. Regarding Aerostar, the description of the business model is included in the sections *Mission, present and future* and *Aerostar's business* within the annual report. There have not been significant changes in the structure or content of the reports available for these two companies.

**Antibiotice** is listed at the BSE since 1997 and the company's website provides annual reports starting with 2003, the first significant content change being in 2009. The presentation of the business model is made in the section *Company's profile*, and the strategy and performance are based on several programs which were

improved and multiplied over time. A simple review of these reports points to a clear evolution of the interactive way to present the business and the achieved performance. The report is quite concise and presents a relatively ascending trend in the number of pages (as a result of the multiplication of the projects undertaken). We consider that Antibiotice Iași can benefit from the Takeda model (Japan), which was analysed by Dumitru and Jinga (2015) in the idea of a potential implementation of integrated reporting.

**Compa** is also listed at the BSE since 1997 and it has available on its website the annual reports since 2008 until present day. A continuous increase of the document's number of pages and an image improvement starting with 2010 has been noticed. The company chooses to use its webpage in order to provide

details regarding the non-financial aspects. The international activity performed by Compa allows it to be included, from the standpoint of integrated reporting, into the category of the regulatory benefits mentioned previously. The company's international activity can also represent a motivation for choosing the practice of integrated reporting, based on the transparency and the reliable and responsible image which it would bring. We believe that, depending on the impact of the non-financial statement that must be prepared starting with January 1<sup>st</sup>, 2017, this company may consider the implementation of integrated reporting, having as a model the approach of the Volvo Group, member of the Pilot Programme initiated in 2011 by the IIRC.

**Conpet** is listed at BSE since 2004 and the users can find on the company's website the annual reports starting with the same year. It has been noted a continuous increase of this document's volume and, in terms of content, the presentation is still made in black and white and follows the same structure.

**Electromagnetica** is listed at BSE since 1996 and its webpage provides annual reports since 2013. The Directors' Reports do not show present changes of format or content in the period 2013-2015. In order to choose integrated reporting, this company has the example of Showa Denki from Japan, also a member of the Pilot Programme initiated by IIRC.

**Nuclearelectrica** is listed at the BSE since 2013. On its website, the annual reports are available for the period starting with 2000. The report for 2000 is in Romanian, in black and white and it is very brief, with only 16 pages. From 2001 until 2007, the report is presented in English and shows improvements both in terms of structure (since 2004 it is presented in colour) and content (larger and more interactive). From 2008 until 2012, the document has a new structure, with an average length of 41 pages, and continuous improvement are made to its appearance. From 2013, the report changes its name from Annual Report to Directors' Annual Report and its structure and quality are reconfigured. The 2014 report is the result of a continuous improvement process, the company presenting the best version of the annual report and getting closer to the concept of integrated reporting. This entity has also an international example in the company State Nuclear Energy (Rosatom) from Russia who was a member of the IIRC Pilot Programme.

**Transelectrica** is listed at BSE since 2006 and its website provides annual reports starting with 2002. Between 2002 and 2005, the annual report contains the financial statements prepared in accordance with the IFRS. Since 2006, the annual report completes its structure with other information in addition to the financial statements, with a continuous improvement until 2011. In 2012, the *CNVM Report* and *Directors' Report* are published as annual reports: the first is prepared in accordance with the CNVM Regulation no. 1/2006 and the second presents, in an interactive manner, the company's activity during the year and its impact on the society and environment. From 2013 to the present, the annual report is a unique document including all the previous reports, with an improved content and structure, with an average length of 143 pages. A model of integrated reporting for this company is Enel from Italy, also part of the IIRC Pilot Programme.

With regard to **Transgaz**, this is listed on the BSE since 2008 and provides annual reports published since 2004. If during the period 2004-2011, the annual report consisted only of financial statements according to IFRS, starting 2011, this document is called the Directors' Annual Report and has a new structure. In 2012, the report started to become increasingly bulky, reaching a number of 212 pages in 2015. From 2013, the report is presented in colour, except for 2015 the company published a scanned black and white report.

In addition, it cannot be said that the only report on corporate social responsibility (last update in 2014) aligns with any IIRF requirement because it deals with only one part of a potential integrated report. However, there are presented the actions and the results of the humanitarian and voluntary programs, the development of the society and environmental protection. The document is interactive, concise, reliable and shows a focus towards the future, but it represents only a part of a potential whole. We believe that, through this document, Transgaz has a starting point in preparing the statement required by the Directive 2014/95/EU and, of course, the potential to choose integrated reporting in the future. A comparison with a company from the same sector which was a member of the Pilot Programme initiated by IIRC, respectively Enagás from Spain, reveals that the Romanian company must keep making steps towards the idea of an integrated report. Meanwhile, although it has a model, the decision to implement integrated reporting depends on the extent to

which this State-owned company considers relevant the efforts to attract foreign investors or prefers to remain in the national community already built and enjoy the responsible image already formed; more specifically, the adoption of the integrated reporting principles depends on the extent to which this company is interested in becoming an international brand.

**Vrancart** is listed at the BSE since 2005 and its webpage provides the annual reports prepared according to the CNVM Regulation no. 1/2006, starting with the same year. The structure of the report is maintained between 2005 and 2011, with an average length of 17 pages. In 2012 the report is presented in a new structure and in a new colour and interactive form. A possible example of integrated reporting for Vrancart could be Fibria Cellulose from Brazil, a global producer of eucalyptus pulp and a member of the Pilot Programme initiated in 2011 by the IIRC.

As for the types of capitals, most of the companies selected for this study do not present in their reports aspects related to the intellectual or social and relationship capital.

Within the integrated reporting principles, there was considered the information contained in all the reports published by each entity. Most of the companies do not comply with the materiality principle, given that they are required to have a list of content elements through the CNVM Regulation. Also, few companies explain how they understand and answer the informational needs of all stakeholders, which is why the principle regarding stakeholders relationships is not fulfilled by most of the companies. Meanwhile, the compliance with every guiding principle can be improved for each company because there were not analysed any integrated reports. The results presented in **Table 3** are determined with a relevant level of tolerance.

After analysing all of these aspects, we consider that, from the selected companies, Antibiotice Iași S.A. has currently the greatest potential to adopt the integrated reporting principles. The annual report published by Antibiotice complies with most of the IIRF requirements and, in addition, its image is very close to the idea of an integrated report. The company is considered to have the greatest potential because of how it explains its business philosophy and value creation process and due to the reduced volume of work that the implementation of these principles would entail. Thus, the company is recommended to approach a superior reporting model,

especially since the company operates on the international market (exports) and integrated reporting can make a difference in outlining its international business card.

Significant changes for the implementation of the integrated reporting are also attributed Nuclearelectrica, as its annual report fulfils most of the IIRF specifications. But the document is still focused on the structural elements mentioned in CNVM Regulation no. 1/2006. Nuclearelectrica receives second place in the hierarchy of companies with the potential to adopt the integrated reporting principles for the continuous improvement of the report's content, especially after being listed.

Among the other companies, due to the fact that have successful models to follow and a sector favourable to investment, to the extent to which they consider it is a good option, the companies that can choose integrated reporting are the following: Romgaz, Transelectrica, Aerostar, Vrancart and Transgaz.

## Conclusions

Integrated reporting is a practice under development and it becomes more and more popular because a lot of companies discover its multiple benefits. The conclusions will be summarized in relation to the papers' objectives.

With regard to the first objective, the last IIRC annual report points that 71% of the investors use integrated reporting in the decision-making process. Thus, beyond the idea of supporting a new trend in the area of reporting, this practice is actually desired by investors.

With regard to the second objective, understanding the sector in which a company operates helps it to draw a better orientation of the reporting towards the non-financial aspects.

From all the industries in which the companies selected for this study operate, the pharmaceutical sector is the best regulated, although companies can have liquidity problems due to the delayed payments in the health insurance system. However, Antibiotice presented a superior reporting model, maybe trying to compensate the possible industry-specific risks and to gain the confidence of the potential investors. This company published in 2015 a report that is the closest one in the sample to the idea of an integrated report: it is concise, interactive, it presents the business model, the value

creation process, the strategy and the results of the environmental and social responsibility policies, with an approach towards sustainable development.

Also, the utilities' industry, particularly the one of natural gases, is characterized by seasonality and questions concerning the free formation of the price. However, four companies that operate in utilities' sector are mentioned on the list of companies with potential for integrated reporting. Out of these, Nuclearelectrica is emphasized, due to proof of a continuous improvement of the reporting quality.

As for the third objective, it can be considered that integrated reporting helps a company to build an international name, primarily due to the comparability of the information. Antibiotice Iași performs exports and, within the companies from the utilities' sector, the decision to implement this practice is linked to the desire and need to become international. It should also be taken into account that participating in international databases and greater comparability of information add to a company's image, but also bring a greater responsibility in the competitive area.

Although it is an EU member since 2007, Romania is still unable to easily adapt to this status (Gușe et. al., 2016). However, through the power of the example, Romania can become a favourable field for the development of

integrated reporting. We believe that the first tool for this purpose is represented by the companies listed at the BSE, which are motivated to become international and to attract more investors. Another impetus in this regard is the implementation of the Directive 2014/95/EU, which will determine large companies to approach non-financial aspects within their reports.

A limitation of this research is that the number of the sectors resulted from the application of the selection criteria is quite small in order to formulate a general view on Romanian listed companies. A solution would be to identify all Romanian companies listed at the BSE and to study their reports. Another impediment was the impossibility to identify a model of an existing integrated report for all companies included in the study. Another limitation is the lack of a discussion with people inside of each company in order to see the entity's position concerning the potential publication of an integrated report.

This study is a starting point, an idea aimed to promote and to grow businesses built on Romanian capital. Issues such as the global trend to approach integrated reporting and the many benefits which were described theoretically and confirmed practically are the incentive for this initiative. The paper aims to widen these companies' (and others') vision on reporting.

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# Internal control and auditing – a necessity for responsible reporting and managerial usefulness of accounting information

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## Abstract

*It is well known that not only in Romania, internal control and auditing are subject to legal regulations. Often, the two forms of ensuring the quality of accounting information are particularly perceived as mandatory requirement instead of as a necessity for certifying the information travelling between producer and user. The paper addresses issues which aim to highlight the need to organize the internal control and auditing of the accounting information from the perspective of the need to certify the accounting information for a responsible reporting. Moreover, through a study conducted on a sample of 301 companies in the Central Region of Romania, we also captured the managers'/directors' opinion regarding the internal control and audit in terms of confidence, ensuring opportunities to valorise the accounting information and its usefulness for management.*

**Keywords:** Control, audit, accounting information, certification, management.

**JEL Classification:** M41, M42.

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## Introduction

At the micro and macro-economic levels, control is “a necessary function of management” (Ionescu, 2010), the control system being an essential instrument for both ensuring the quality in terms of the value and usefulness of accounting information, and for monitoring and improving activities. The successful achievement of the objectives pursued by the internal control is not a certainty. In our opinion, one of the main limitations with implications on the opportunities to valorise the accounting information for management (internal or external information) lies in the biased attitude that may occur in internal control, which is directly related to ethics and authority. If independence is the foundation of professional ethics in auditing, we believe that the auditing of accounting information is required for more responsible information that would provide the expected confidence to internal and external users. However, audit does not have a predictable character. It does not cover all of a company’s transactions, but only some of them, which is why, as conceptual approaches say, the auditor seeks a “reasonable assurance” and not an absolute one.

All these issues have led to the identification of this research’s objectives. Therefore, in the first part we perform a synthesis of the specialists’ views and of the national and European legislative framework regarding the internal control and audit, the statutory/financial audit, the accent being placed on presenting their advantages and limitations in terms of the control and assessment function of the management. The second part presents an exploratory study conducted on a sample of 301 companies from the Romanian Central Region.

## 1. Empirical and theoretical framework

In Romania, according to the Accounting regulations on annual individual financial statements and annual consolidated financial statements approved by the OMPF 1802/2014, the management must provide, through the internal control, an assurance that the targets set are coherent and the factors that contribute to achieving the objectives have been identified. Moreover, the same regulation stresses the need for internal control in terms of ensuring real-time information regarding the obtained

performances and the company’s prospects. The regulation emphasizes that the activities undertaken should be part of the management process. It is thus emphasized the integration of internal control within the functions of the company’s management and the need to achieve it by determining the legality, reality, opportunity, effectiveness and efficiency of the operations performed, and by developing useful mechanisms for the management to incorporate the accounting information (Guinea, 2011). Thus, internal control functions can be synthesized, according to experts (Bogdan, 2004; Popeangă and Popenagă, 2004) in knowledge, assessment, prevention, research, recovery, education and stimulation, learning and self-learning.

Within the economic entities, internal control proves its *usefulness* in generating opportunities to valorise the accounting information and ensuring the usefulness of the information for management by the fact that it aims to provide:

- Compliance of documents, operations, processing, and reporting with the regulations;
- Identification of the reality of assets, liabilities and equity;
- Implementation of decisions made by managers;
- Proper functioning of the company’s internal activities;
- The reliability of financial information;
- Adequacy of resources’ allocation consistent with the set targets;
- Resource efficiency;
- Increase of accountability of decision-makers in engaging and performing any transaction;
- Verification of contracting, utilization and repayment of loans of any kind;
- Verification the conditions for the appointment or election of directors, board of directors, managing committee and auditors;
- Verification of activities on the issuance of shares or bonds;
- Verification of correct declining of strategic objectives;
- Execution of budgets;
- Profitability of activities, products and management centres, profit and performance centres (if implemented);

- Supervision of cash receipts and payments;
- Prevention of irregular accounting practices;
- Prevention of registering minuses, their detection and recovery when appropriate;
- Prevention and control of risks for the failure to achieve targets;
- Avoiding excessive costs or overestimating them;
- Signing contracts with internal and external partners, checking the organization of auctions;
- Checking cash receipts and payments of any kind;
- Distribution of profit for the financial year etc.

This conclusion is derived from the analysis of the views of experts in the field (Popeangă and Popeangă, 2004; Aslău and Almasi, 2011) and the applicable legislation:

- OMPF 1802/2014 – Accounting regulations on the annual individual financial statements and annual consolidated financial statements;
- OMPF 923/2014 – Rules on the preventive financial control and the Specific code of professional rules;
- Ordinance 119/1999 on internal auditing and preventive financial control, republished;
- OMPF 946/2005 for the approval of the Code on internal/management control, including internal/management control standards in public institutions and for the development of internal/management control systems, republished;
- OMPF 2861/2009 for the approval of Rules for organizing and conducting inventory of assets, liabilities and equity).

However, companies generally face a number of *limitations* in the organization and performance of internal control, which has a negative impact on certification and hence on the use of accounting information, taking into account the degree of trust that users can have in the information reported. Among the limitations of internal control, we can mention the organizational culture, associated costs, detection risks, inadequate procedures, ethics, integrity, professionalism of those involved, the management authority manifested by pressures etc.

*But is internal control enough?* As presented, the internal control has certain limitations. From this perspective, additional requirements may be imposed to

ensure the quality and certification of the accounting information. Thus, the role of internal audit (Ciuhureanu and Baltas, 2010) and of the financial audit (Ciuhureanu and Popa, 2007). Moreover, the Directive 2013/34/EU stipulates that “financial statements should be audited”, an obligation that will not be imposed to small enterprises. Through these specifications, the options of Member States are not restricted; instead, the possibility of imposing an audit on small enterprises is outlined, depending on their specific conditions and needs.

The literature presents most often the audit as an objective examination involving a professional and ending by the expression of an independent opinion.

From the perspective of the organization there are two types of audits – internal and financial/statutory – in both cases being required the financial auditor certification. However, the accounting information was often omitted by the internal audit or it was given a lesser importance, the role of internal control being emphasized. The importance of internal audit for the certification of accounting information was highlighted in the case of public institutions by the approval of Law 672/2002 on internal public audit, and later on for the private entities by the CAFR, which adopted Decision 88/2007 on the approval of Internal audit regulations and the International Standards for the Professional Practice of Internal Auditing, which stress its independent and objective character, the assurance and advisory role, the purpose of supporting the assessment and evaluation of objectives and improving the effectiveness of risk management, control and governance.

To emphasize the importance of the internal audit and the close relationship with the accounting information, in the Ordinance No. 75/1999 regarding the financial audit activity, republished, the mandatory character of organizing the internal audit is stipulated for all economic entities whose financial statements are subject to financial audit. Moreover, the Romanian Association of Internal Auditors (Asociația Auditorilor Interni din România - AAIR) was founded, thereby recognizing the profession of internal auditor. In 2014, the CAFR adopted Decision No. 48/2014, through which the binding rules of the International Professional Practices Framework (IPPF), issued by the Institute of Internal Auditors (IIA Global) are fully adopted, including the definitions, code of ethics and specific standards of internal audit.

According to the opinions of specialists in the field and the applicable regulations (Suciu and Savloschi, 2003; Mitea et al., 2005; Macarie, 2011; OUG 75/1999 on the activity of financial audit, republished), through the actions carried out, the internal audit contributes to the certification of the accounting information at least by checking the compliance of records, evaluating the adequacy and application of internal control in the financial-accounting field, protecting the items from and outside of the balance sheet, preventing accounting fraud, ensuring the reliability of accounting information, identifying and minimizing the risk of accounting error, assessing the desirability, compliance, economy, effectiveness and efficiency of transactions recorded in accounting, development of SWOT analysis of the accounting activity, monitoring the entire management system etc.

In conclusion, all the approaches regarding the internal audit emphasize its independence and preventive character, and through its components – system audit, performance audit, regularity audit (Ghiță, 2009) – highlight the need for the internal audit to have as a main goal the prevention of disruptions, given the fact that the management is required to be fully interested to consider, appreciate and capitalize on the findings (Morariu and Crecană, 2009; Ghiță, 2006). Thus, internal audit is a necessity, not only an obligation.

The second type of audit which we refer to from the perspective of the quality certification of accounting information provided to users is the financial audit. It includes the statutory audit according to Ordinance No. 90/2008 on the statutory audit of annual financial statements and the annual consolidated financial statements and the public interest supervision of the accounting profession, as defined by Ordinance No. 75/1999 regarding the financial audit activity, republished, as an activity performed by a professional - financial auditor - that aims to express *an opinion on the financial statements or components thereof*. Financial audit missions may be more diverse than statutory audits, which focus on the legal obligation to audit the financial statements. Within the European Union, the Directive EC/43/2006 on the legal audit of annual accounts and consolidated accounts endorses the use of the term “legal audit” defined as the audit of annual or consolidated accounts, and by the Directive 2014/56/EU it is replaced with the term “statutory audit”.

In Romania, the audit’s mandatory character for certain entities is established by the Order 1802/2014 of the Ministry of Public Finances for the approval of

Accounting regulations on the annual individual financial statements and annual consolidated financial statements, which, according to art. 563(1) requires the audit of financial statements by statutory auditors or audit firms. According to the International Standard on Auditing 200 “Overall objectives of the independent auditor and the conduct of an audit in accordance with international standards on auditing” and Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of enterprises, the objective of financial statements’ audit engagement is to allow the auditor to certify the true and fair view of the financial statements in terms of preparation and compliance with the applicable legal framework. In support of entities and statutory auditors/audit firms in the European Union, the Regulation 537/2014 was adopted, which provides specific requirements applicable to the statutory audits of public interest entities.

The decision to use the financial statements may be based on the auditor’s opinion regarding those statements, which may be unqualified - the ideal situation, qualified opinion, disclaimer of opinion or adverse opinion, the latter generating a warning signal to users. Certainly, fraudulent financial reporting may be dependent or independent of management. Considering the above approaches, we believe that the opportunities offered by the financial audit are mainly found in the increase of financial statements’ reliability by taking into account the risk of material misstatements as a result of fraud or error (Todea and Stanciu, 2009).

## 2. Research methodology

The decisional issue identified by previous studies (Ciuhureanu, 2015) is the fact that there is a low level of recognition of *the duties of persons engaged in the internal control activities (auditors) and of the importance of internal and financial audit – both being important factors for the success of the company, providing trust in the accounting information and increasing chances of it being truly useful*.

The functional purpose of this research frames it, according to the typology made by Cătoi et al. (2009), into the category of descriptive-explanatory typologies; based on the type of data, it is a quantitative research. The objectives, the variables used to achieve them, and the research hypotheses are presented in **Table 1**. We note that we maintained their original numbering, the present research being part of a more complex study, based on 16 objectives.

**Table 1. Objectives, variables and hypotheses**

Hypothesis	Main variables – code and type	Secondary variables – code and type	Specific objectives	Secondary hypotheses
<b>Main objective:</b> Q <sub>9</sub> Analysis of the opinion regarding the internal control and audit in terms of ensuring the opportunities to valorise the accounting information through its certification and increase of its usefulness in the management process.				
IP <sub>31</sub> – Internal control and audit contribute to a large extent to responsible reporting, certification, the increase of trust and provides opportunities to capitalize on the accounting information	v51 Multiple choice/5 steps Likert scale	v1 Multiple choice/Closed, single answer	Q <sub>9.1</sub> Analysis of the attitude regarding the internal control depending on the company's category and industry	IS <sub>19</sub> There is a direct relationship between the positive perception on the influence of the internal control and the company's category/industry.
	v52 Multiple choice/5 steps Likert scale	v2 Multiple choice/Closed, single answer	Q <sub>9.2</sub> Analysis of the attitude on the internal audit, depending on the companies' category.	IS <sub>20</sub> Positive perception of the audit's influence on the usefulness of accounting information varies directly, according to the company's category.
	v53 - Multiple choice/5 steps Likert scale			

Source: Author's processing.

The method on which this study relied on is the direct research, through a survey, based on a questionnaire. The sample comprised 301 companies in the Centre Region, being a non-probability sampling built using the „Snowball” method and with an error of ± 5.63%. Although at first glance the method can be considered a limitation of the study, we stress that we resorted to this method because of the complexity of the research instrument, population diversity (active companies in the six counties in the Central Region), difficulties encountered in distributing and collecting the questionnaires, and especially difficulties deriving from the availability of respondents. Moreover, the impossibility of building a representative sample from the perspective of stratification also originated, on the one hand, from the lack of updated statistical data provided

by for the counties in the Centre Region, and on the other hand, from the impossibility to identify a ranking of companies based on certain criteria (for example the type of capital).

### 3. Results of the study

Through the research conducted we aimed at knowing the attitude vis-à-vis the organization and practice of internal control in terms of confidence, ensuring opportunities for capitalizing on the accounting information and its usefulness for the management. In this regard, the operational variable v51 was formulated in the questionnaire, the responses being presented in Table 2.

**Table 2. Attitude on the internal control from the perspective of ensuring the opportunities of capitalizing on the accounting information and its usefulness for the management**

Code	Opinion	Frequency	Percentage	Valid percentage
1	To a very small extent	28	9.30	9.30
2	To a small extent	33	10.96	10.96
3	Neither to a small, nor to a large extent	56	18.60	18.60
4	To a large extent	157	52.16	52.16
5	To a great extent	27	8.97	8.97
	Total	301	100.00	100.00
Score	3,41			

Source: Author's processing.

In the first part of the article, we captured both the opportunities and limitations brought by internal control in the capitalization and usefulness of the accounting information. The respondents' opinion, identified by the score of 3.41, is that internal control only contributes in a small way to obtaining useful and responsible information. The opinion is in total disagreement with the trend set out above. It is possible that this result has been achieved by the respondents unconsciously

connecting the internal control as an activity to the costs which it would entail, a fact that is usually reflected on their opinions.

*Through the specific objective Q<sub>9.1</sub> we analysed the attitude on the internal control depending on the companies' category and field of activity (associations of v51 with v2 and v1 – Table 3), criteria that we had in view throughout the entire research.*

**Table 3. Attitude regarding the internal control, depending on the company's category and field of activity**

Opinion	Category (%)				Industry (%)				Total %
	Micro	Small company	Middle-sized company	Large company	Commerce	Industry	Services	Agriculture	
1	12.84	10.71	0.00	0.00	8.20	0.00	11.61	50.00	9.30
2	15.54	8.33	5.77	0.00	11.48	0.00	15.48	20.00	10.96
3	21.62	19.05	13.46	5.88	13.11	18.67	20.00	30.00	18.60
4	46.62	58.33	67.31	23.53	44.26	69.33	50.32	0.00	52.16
5	3.38	3.57	13.46	70.59	22.95	12.00	2.58	0.00	8.97
<b>Score</b>	3.12	3.36	3.88	4.65	3.62	3.93	3.17	1.80	3.41
<b>Total</b>	148	84	52	17	61	75	155	10	301
<b>%</b>	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: Author's processing.

Again, the comprehensive analysis depending on the company's category reflects the dependency of respondents' attitudes on the company's size. Thus, if the majority of 70.59% of respondents classified in the category of large companies believes that by organizing internal control the accounting information becomes very useful to the management (score 4.65), the perception has a decreasing trend, the usefulness reaching a neutral value in the case of micro-entities (score 3.12). We must however note that for none of these companies an overall negative opinion has been revealed about the benefits of internal control, be it ensuring compliance of documents, operations, processing, reporting with the legislation in force; implementation of management decisions; prevention, detection and remediation; checking receipts and payments of any kind etc.

Depending on the field of activity, companies from the industry sector recorded the highest score (3.93), most of them considering that through the internal control activities accounting information largely becomes

useful. A similar view is highlighted for companies from the trading sector, the score of 3.62 being much closer to the value of 3.5 (maximum for neutral opinion). In the category of neutral opinion, we find the services sector (score 3.17), the situation being predictable if we consider that many of the companies operating in this field are micro entities. For agriculture, the score is 1.8, which indicates that the respondents believe that through the internal control, the accounting information becomes useful to management to a small extent.

Based on the results obtained, the specific hypothesis *IS<sub>19</sub>* – *There is a direct relation between the positive perception on the influence of internal control and the company's category/field of activity* is confirmed.

For analysing the opinion regarding the audit in terms of confidence, ensuring opportunities to capitalize on the accounting information, certification and usefulness for the management, questions v52 and v53 were formulated in the questionnaire. The answers are processed in **Table 4**.

**Table 4. Audit contributes to responsible reporting, increase of trust and offers possibilities in capitalizing and making the accounting information useful for the management**

Code	Opinion 301	Internal audit			Financial audit		
		Frequency	Percentage	Valid percentage	Frequency	Percentage	Valid percentage
1	To a very small extent	15	4.98	4.98	6	1.99	1.99
2	To a small extent	27	8.97	8.97	18	5.98	5.98
3	Neither to a small, nor to a large extent	61	20.27	20.27	58	19.27	19.27
4	To a large extent	162	53.82	53.82	172	57.14	57.14
5	To a great extent	36	11.96	11.96	47	15.61	15.61
	Total	301	100.00	100.00	301	100.00	100.00
<b>Score</b>				<b>3.59</b>			<b>3.78</b>

Source: Author's processing.

The analysis of data obtained for both types of audit and the calculated scores (3.59 - internal audit in financial-accounting field and 3.78 – financial auditing) highlights the audit's high usefulness for responsible reporting, certification of accounting information, providing opportunities for the capitalization and management usefulness of accounting information. It is however noted that there was not obtained a score above a value of 4.00, reflecting the uneven distribution of the responses.

Detailing the findings was based on formulating the secondary objective Q<sub>9.2</sub>– *Analysis of attitude on audit depending on the companies' category* and it was made by associating v52 with v2 and v53 with v2 – **Table 5**. We only chose the criterion company's category because, after the analysis of v51 with v1 (field of activity) we noticed that the results were not conclusive.

**Table 5. Audit contributes to responsible reporting, increase of trust etc. – association depending on the category**

Opinion	Category/Internal audit (%)					Total %	Category/Financial audit (%)				Total %
	Micro	Small company	Middle-sized company	Large company			Micro	Small company	Middle-sized company	Large company	
1	8.78	2.38	0.00	0.00		4.98	4.05	0.00	0.00	0.00	1.99
2	12.84	9.52	0.00	0.00		8.97	12.16	0.00	0.00	0.00	5.98
3	29.73	13.10	11.54	0.00		20.27	30.41	11.90	5.77	0.00	19.27
4	47.30	69.05	53.85	35.29		53.82	53.38	84.52	38.46	11.76	57.14
5	1.35	5.95	34.62	64.71		11.96	0.00	3.57	55.77	88.24	15.61
<b>Score</b>	3.20	3.67	4.23	4.65		3.59	3.33	3.92	4.50	4.88	3.78

Source: Author's processing.

Regarding the contribution of internal audit in the financial and accounting fields, the opinion of most respondents from large companies (64.71%) is that it makes an essential contribution (score 4.65). It is a

predictable result, especially if we consider that many of the large companies actually organize the internal audit. Most respondents representing the medium and small companies (53.85% and 69.05% respectively)

consider that internal audit plays a significant role (score 4.23 and 3.67, respectively) in the certification and usefulness of accounting information. In the case of micro-entities, the score of 3.20 is a good one because, as stated in the conclusions drawn from v51, their opinion was influenced by the potential costs entailed by this activity (qualification of personnel, development of procedures, information technology) and the majority of companies in this category do not organize internal audit, since it is not mandatory.

For the financial audit, the situation is similar to the previous one. We note, however, the significant increase in the share of respondents from large companies who confirm the essential contribution of internal audit in ensuring the usefulness of accounting information through certification, as compared to that related to the internal audit (from 64.71% to 88.24 % and a score of 4.88).

Large companies at audit their financial statements, and the auditors expressing a favourable opinion contributed to, or may contribute in the future to attracting capital, gaining the confidence of business partners or of the public, which is viewed as a potential generator of income. In the case of medium-sized companies, in terms of the internal audit's usefulness in generating reliable accounting information, the score of 4.23 (to a great extent) was obtained. Regarding the financial audit, the score reaches the value of 4.5, placing the respondents' opinion on the limit of "to a great extent". Moreover, a majority of 55.77% expressed this opinion. It is thus highlighted a change in the situation, which, in our opinion, may arise from the respondents' awareness of the independence of financial auditors and their confidence that auditors cannot afford, from a professional perspective, to express an inconsistent opinion. We state, however, that internal auditors are subject to the fundamental principle of independence in carrying out their activities.

After making the associations, the specific hypothesis *IS<sub>20</sub> – Positive perception regarding the influence of audit on the usefulness of accounting information for the management varies directly, depending on the company's category* is confirmed.

At the end, based on the interpretations, we partially validate the launched hypothesis (*IP<sub>31</sub> – Internal control and audit contribute greatly to responsible reporting, the increase of confidence and provides opportunities for the capitalization and usefulness of accounting information for the management*). The biased attitude derives from the lack of confirmation regarding the attitude on the internal control, and also from placing the internal audit at the lower limit of confirmation.

## Conclusions

To ensure that they benefit from conclusive information, based on ethics, accurate and timely, the users of accounting information have at their disposal the control-evaluation function, which, in accounting can be identified as the internal control and audit activities. Following those presented, we believe that organizing the internal control and audit, through their objectives, contributes to the accountability for providing accounting information and increases users' confidence.

Moreover, for the management, these activities contribute to a more efficient organization, ensuring economic and financial discipline, resources' efficient management, compliance with rules, procedures, regulations, actions which are ultimately reflected in the reported accounting information and in the users' decisions. They should not be regarded as an obligation, but as a necessity to support the management in achieving the goals, identifying and eliminating risks, by means of useful, real and unmasked financial accounting information.

Furthermore, the financial auditor is expected to provide opinions and bring into focus issues from the perspective of the information user, thus being the interface between reporting and quality of information. The condition is to have supporting the auditors' role as a managerial objective. It remains, however, at the discretion of managers and administrators to decide which are the priorities of the business, and thus to determine the cost/benefit ratio regarding the achievement of the control-evaluation function, by organizing the internal control and audit of accounting information.

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# Study regarding the impact of cultural factors on management accounting systems

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## Abstract

The objective of the study to investigate the less clear aspects of the cultural influences on the objectives-setting process and on the procedures for the adoption and implementation of a management accounting system. To achieve this objective, the study uses a research methodology which is mainly qualitative, with insertions of field research findings generated by the author. Cultural factors and the environment in which an entity operates affect the strategic objectives of management accounting systems. The key contribution of the study is that it identifies significant evidence that an entity's the strategic objectives of may vary depending on national and cultural characteristics. It is stated that there are numerous factors that may explain these variations, but all of them are governed by the cultural dimension. Inevitably, Romanian entities are placed in a specific cultural context. The study identifies the specific cultural dimensions and how they influence the process of defining goals within management accounting systems. National management accounting systems currently lie in relatively conflictual area generated by the permanent confrontation of local values and mentality with the effect of international convergence. The reflections presented in the study are a starting point for identifying, analysing and reconciling all the factors that crystallized or erode a modern and efficient system of management accounting.

**Keywords:** Managerial accounting, culture, national differences, setting objectives.

**JEL Classification:** M41

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## Introduction

Any managerial accounting system should consider the scale of cultural changes required for its adoption. It is useless to implement the system by imposing a decision hierarchically. A modern system can be viable only through daily inputs from its main users. If they do not adhere to the system, then the system is condemned to extinction. Explanation and training efforts should be oriented towards cultural change, rather than towards the presentation of techniques.

The origin of this challenge may seem, on first examination, quite simple: the study of similarities and differences between the accounting systems should not be limited to financial accounting. It was stated that the accounting systems are influenced and determined by a number of factors such as the economic, financial, political, legal, social and cultural environment. The phenomena of growth and globalization have led to a sharp rise in financial information needs. Under these circumstances, both financial and managerial accounting are different in content and scope from one country to another. Accounting is a social construct and, therefore, it reflects the characteristics of a cultural group, such as the society in which a company operates (Feleagă, 1999).

In general, the organizational culture is defined as an *organizational imaginary* (Larçon and Reitter, cited by Bescos et al., 1997), i.e. a set of images, representations, beliefs regarding the organization, its operations, what is good or bad and the different behaviours and actions. This imaginary is manifested through *symbolic productions* in the form of rites, myths, practices and customs.

Culture is the product of the organization's history. Consequently, it is constituted progressively according to its experiences and the retained solutions, thus creating positive or negative references, but always shared. This forms an entire set of representations that each new member will face, interpret, internalize and circulate, without necessarily being aware of these interpretations and their influence on his behaviour.

By the enhancing mechanisms, more or less powerful intolerance towards those who deviate, the recruitment of persons who have an adapted profile, culture tends to become increasingly more coherent, up to manifesting a *true authority* over the individuals (Pagès et al., 1981). The organization is then marked by a strong culture,

which can be a competitive advantage: improved coherence of behaviours from the organization's members, involvement of employees, a high degree of cooperation. But it is also generating inflexibility, limiting the organization's ability to adapt to its environment. Thus, an organization made up of individuals with a common past is marked by a given culture that, powerful or diffuse as it is, will influence the behaviour of its members and, accordingly, will affect to some extent the operation of the management accounting system.

The contributions of this research are focused on studying the implications of cultural factors with regard to defining the objectives and adopting coherent management accounting systems, and the role of national differences in the implementation and functionality of management accounting systems.

The study is important for professional accountants and auditors, especially in terms of understanding the motivations and behaviours underlying the implementation and functionality of management accounting systems. The main conclusion is that any implementation of a management accounting system must be preceded by a comprehensive approach for identifying the mix of cultural footprints and national characteristics of the environment in which that system will operate.

In terms of structure, the next section presents the state of knowledge in the field of cultural impacts on management accounting systems. The third section highlights the research methodology, and it is followed by the analysis of research results in sections four and five. The conclusions are outlined in the last section.

## 1. Literature review

The international literature includes relevant empirical studies and research in terms of the influence of cultural factors over the implementation, organization, functionality and setting strategic objectives of management accounting systems (Abdalah and Keller, 1985; Hofstede and Bond, 1988; Gray, 1988; Appleyard, Strong and Walton, 1990; Bailes and Assad 1991; Johnson and Byington, 1993; Amat, Carmona and Roberts, 1994; Bescos et al, 1997; Ahrens, 1997; Sharp and Salter, 1997; Nobes and Parker, 1998; Amat, Blake and Wraith, 2000; Gray, Salter and Radebaugh 2001).

All these studies invariably show that the impact of culture on management accounting systems is very

strong, and the general conclusion is that the objectives of entities in different countries vary considerably. Asian entities are considered to be less individualistic and more long-term oriented. They focus less on immediate gains and choose targets specific to long-term stability. By contrast, Anglo-American entities generally favour the short-term approach and set more profit-oriented objectives such as, for example, the return on investment (ROI).

Comparative studies of national management accounting practices began to be published only in the second half of the '90s. Relevant in this regard is the synthesis-study by Amat, Blake and Wraith (2000) that identifies several key factors by which it is explained why different countries develop different management accounting practices. In fact, the study of Amat, Blake and Wraith (2000) is based on the analyses carried out by Lizcano (1996) in 11 Latin-American countries and also Spain and Portugal and by Bhimani (1996) in 11 European countries, and also Macintosh (1998), Shields (1998) and Birkett (1998).

The national literature can be characterized only in recent years by a production of works that capture the issue of cultural differences in setting objectives and implementation of management accounting systems (Feleagă, 1999; Ionașcu, 2003; Albu and Albu, 2003; 2004).

## 2. Research methodology

A mainly qualitative research methodology was used for the purpose of presenting and analysing the impact of cultural factors on management accounting. In this respect, the documentary research, analytical research, opinion and comparative analysis were used as research strategies. Documentation was performed based on various studies and analyses regarding the relationship between the cultural aspects and the managerial accounting systems. Also, in the context of field research conducted on a sample of 20 Romanian companies in the field of civil engineering between 2010 and 2015, some conclusions regarding the impact of cultural factors on national systems of management accounting were considered.

The hypothesis of the study is that in the field of management accounting there can be found a direct association between the strategic objectives, the methods of quantifying these objectives, the entities' managerial analysis tools and the national environment and culture (with all the involved sub-factors) in which

the entities operate. The inherent limitations of all related studies are generated by the specificity of the addressed field, the difficult economic modelling of the manifested variations, subjectivism, the increasing trends of economic globalization and international convergence, and the size of the samples that formed the basis of empirical research.

The comparative analysis of the results regarding the cultural dimension of managerial accounting systems can be a starting point to extend the studies that identify the behavioural aspects of implementing these systems. The successful implementation of managerial accounting tools depends not only on the relevance of the method in itself, but also on how the method is implemented and accepted by the entity's members. The oscillation between a forced or a consensual implementation will always be a problem of culture and mentality (Albu and Albu, 2003). One of the essential characteristics of any management accounting system is its compatibility with the cultural environment.

## 3. Culture between national characteristics and international convergence

The attempt to understand the different cultural foundations of management accounting can be considered a paradox, given the obvious pressures in favour of international uniformity. Apparently, wherever we are located, there seem to be common interests in increasing the intensity of using similar financial accounting practices. However, on closer analysis, two trends may be revealed: the increased awareness of the cultural specificity and the threat of international harmonization. However, local interests may be favoured, in violation of international trends.

Mixing local and global objectives is more visible in the field of financial accounting. With the development of the European Union single market policies, the awareness of cultural differences has been greatly enhanced. Intensifying the identification of differences itself created a greater awareness of national elements. Harmonization and standardization policies have generated a more in-depth analysis of national practices that can be modified by international rules and directives. Regional and, later, international standardization pressures in the field of financial accounting resulted in the development of national accounting identity (provided that it did not already

exist). Therefore, the national and cultural specificity is not necessarily in opposition with the internationalization. The two can generate creative and constructive relationship with one another.

In the field of management accounting, the relationship between national and global cannot be understood immediately, although it seems that non-compliance with international practices favours, to some degree, the reflection on the specificity and prevalence of national practices. In this area, there are also other reasons on trying to understand the differences between the national and global levels, as well as the interaction between them. Being tightly connected to other corporate practices and management issues, the form, function and importance of management accounting systems may vary depending on their position in the complex structures of organizations. Different cultural configurations can involve different explanations of economic factors and can result in different forms of management, and, through it, the different forms of economic calculations.

Another starting point can be renowned study by Hofstede (1991, cited by Feleagă, 1999; Gray, Salter and Radebaugh, 2001; Nobes and Parker, 1998) on cultural values. The concept of culture has been defined almost axiomatically as a collective mental programming which distinguishes the members of a group from the other individuals. To describe national cultures, Hofstede used the following criteria or dimensions that affect

every decision made by an individual, a company, with special reference to the economic activity:

- *Individualism opposable to collectivism.* The fundamental issue addressed by this dimension refers to the degree of independence of individuals within an entity.
- *High or low hierarchical distance.* Hierarchical distance is the extent to which an entity's members accepts that power is unevenly distributed within organizations, which affects behaviours.
- *Strong or reduced control of uncertainty.* In this case, it is the degree to which members of an entity do or do not feel threatened by the uncertainties of the future.
- *Masculinity as opposed to femininity.* Masculinity is represented by characteristics such as courage, aggression, domination, decisiveness, determination, ambition, heroism. By contrast, femininity generates propensities towards modesty, respect, human relations and life quality, protective behaviours.

In 1988, Hofstede and Bond identified another cultural dimension called Confucian dynamism or long-term orientation versus short-term orientation. This dimension separates the entities with a long-term strategy (Asian) from those favouring a short-term focus (Anglo-Saxon and European).

An attempt to quantify these cultural variables is reflected in the analysis of the data in **Table 1**:

Countries	Individualism	Long-term focus	Masculinity	Hierarchical distance	Control of uncertainties
USA	91	29	62	40	46
Australia	90	31	61	36	51
United Kingdom	89	25	66	35	35
Canada	80	23	52	39	48
New Zealand	79	30	58	22	49
Germany	67	31	66	35	65
South Africa	65	-	63	49	49
Japan	46	80	95	54	92
Mexico	30	-	69	81	82
Hong Kong	25	96	57	68	29
Singapore	20	48	48	74	8
Taiwan	17	87	45	58	69
Mean	38	33	49	60	68
Interval	6-91	0-118	5-95	11-104	8-112

Source: Hofstede, 1991, cited by Gray, Salter and Radebaugh, 2001; Nobes and Parker, 1998.

At least theoretically, Hofstede (1991, cited by Feleagă, 1999) stated that there is a considerable probability that certain cultural aspects also affect the management accounting systems.

These ideas are reflected in the first papers in the field of financial accounting, which connect the cultural context and the practice of financial reporting (Gray, 1988, the four values of the accounting culture: accounting profession – legal control, uniformity – flexibility, conservatism – optimism, discretion – transparency).

In the case of Romanian entities, the classification based on these cultural dimensions is relatively difficult and it is also characterized by dynamism, or even volatility. Another significant factor influencing this classification is the mix between local and imported cultural values, between national reluctance and the assimilation of new elements. Subject to the author's bias and considering the economic aspects, based on field research conducted in the context of Romanian entities, the cultural dimensions specific to the Romanian environment, relevant for management accounting are:

- A long transition from a forced collectivism to above average individualism;
- Exaggerated orientation towards relevant targets on a very short term;
- Masculinity, including the less positive aspects specific to this dimension;
- Hierarchical great distance, induced by the strong manifestation of authority;
- Reduced control of the uncertainties generated by the short-term orientation and manifestations of a less stable economy.

These cultural characteristics of Romanian entities become more apparent in the context of budgetary processes. In the national context, the network of budgets invariably creates a correlation between performance and individual rewards. Also as a result of individualism, accountability and sanctioning procedures are ubiquitous at the individual rather than the group level. Big hierarchical distance seems to erode the participatory budgeting process and subsequent adjustment actions are limited. Uncertainty control has a low efficiency, budgeting is carried out on

the short term and it is not very detailed, the predominant focus being the short-term objectives.

#### 4. Culture and its influence on management accounting systems

Any managerial accounting system includes a performance measurement system. This is a process that enables the convergence of individual goals with the overall objectives of the organization. This convergence of goals is a prerequisite for the development of a management accounting process. The mechanism requires a continuous involvement of stakeholders. Convergence will be strengthened or undermined by the nature of the selected performance measurement system.

The involvement of those accountable is essential at every level, the main features being (Bescos et al., 1997) that they:

- Must participate in setting objectives and ensure that, besides being ambitious, yet realistic, they are correlated with the overall objectives of the organization;
- Play an important role in estimating what means should be employed to achieve the objectives. Sometimes, very specific skills are needed, held only by a limited number of persons. It is of paramount importance that those persons get involved in the process of selecting the economic means to be used and establishing how those means are used;
- Any results measurement system, which is essential for the development of a management accounting process is based on the production of reliable information on a regular basis. Also, in this regard, the action of various operational responsible is fundamental, as they contribute to the quality and speed with which information is produced;
- A management accounting system has no importance unless the differences between the objectives and results give rise to corrective actions. The results highlighted, no matter how accurate, will be of no use if the responsible persons involved will not take them into account, in

order to adopt the corresponding corrective actions.

A management accounting system does not function automatically. The quality of its deployment depends largely on the willingness to engage of those responsible at different hierarchical levels. This can be implemented through a performance measurement system, most often associated with a performance rewarding system.

Gray, Salter and Radebaugh (2001) identified the main premises around which any managerial accounting system is developed:

- Organization's strategic objectives;
- Resources to achieve the strategic objectives and the means of providing them;
- Existence of functional systems for warning, adopting corrective measures and analysis of achieving the strategic objectives;
- Ways for assessing and rewarding the managers' performance;
- The impact of the organization's internal and external environment on the analysis and information needs;
- The impact of national characteristics on the previous items.

Various empirical studies carried out in the international literature show that the influence of each cultural dimension on the previous premises is not always very clear and there are many situations where they need to be addressed in conjunction. The main findings showed that the cultural dimensions that have the strongest impact are the degree of individualism, hierarchical distance and long-term orientation. At the same time, the criteria for uncertainties control and masculinity have a reduced influence. In our opinion, all five dimensions manifest their presence in a correlative and integrative manner within the processes of organization, implementation and operation of management accounting systems.

Culture influences behaviours in a general manner, but it particularly affects the determination and the nature of the objectives (Bescos et al., 1997). The cultural dimensions of an organization are likely to influence

the modalities adopted for measuring the results. The relationships between the setting of objectives, achieving of results and the cultural influences generate the measure of performance. By confronting the results with the objectives and interpreting them in terms of culture, a more subjective approach is revealed, as well as the exposure of a value judgment regarding the effectiveness.

Several empirical studies (Abdallah and Keller, 1985; Appleyard, Strong and Walton, 1990; Shields et al., 1991; Bailes and Assada 1991; Ueno and Sekaran, 1992; Harrell and Harrison, 1994; Harrison et al., 1994; Gray, Salter and Radebaugh, 2001) illustrate that an entity's main objectives vary considerably depending on nationality, economic and social development and cultural aspects. Among the most frequent objectives of management accounting systems, measured by financial indicators, we can include profit, turnover, gross margin, commercial profitability, residual profit, economic value added, return on investment, reducing production costs, comparison of budgets and achievements, market share. Each of those objectives has advantages and disadvantages, always being connected with the specific features of the business entity and analysed in a specific cultural context.

The findings of these empirical studies have shown that cultural divergence divides entities from different countries into two main categories, each category being represented by the United States of America or Japan; all other countries can be "assigned" similar cultural characteristics as one of these two representatives. The groups of Anglo-American companies show a significant preference for objectives measured by the return on investment (ROI), budget analysis, profits, turnover. Japanese groups entail a completely different approach, as they favour the objectives characterized by turnover, production costs, profits, gross margin, and market share, while the presence of ROI is almost insignificant. We believe that the most relevant studies in this regard are represented by Shields et al. (1991) and Bailes and Assada (1991), whose conclusions are summarized in **Tables 2 and 3**.

**Table 2. Correlation between setting goals and the managers' assessment**

Objective	Japan (%)	United States of America (%)
Turnover	69	19
Increased turnover	28	28
Market share	12	19
Assets' rotation speed	7	13
Commercial return	30	26
Return on investment (ROI)	7	75
Controllable profit	28	49
Residual profit	20	13
Operating result	44	38
Production costs	28	13
Others	8	17

Source: Shields et al., 1991.

**Table 3. Setting the budgetary targets**

Objective	Japan (%)	United States of America (%)
Sales	86,30	27,90
Operating result	44,70	35,00
Controllable profit	28,20	51,80
Gross margin on sales	30,70	30,50
Increased turnover	19,40	22,40
Return on investment (ROI)	3,10	68,40
Production costs	40,70	12,40

Source: Bailes and Assada, 1991.

In the context of the sample of Romanian entities that were subject to field research there has been revealed that the setting of goals is closely correlated with cultural dimensions mentioned above: The rapid and more or less forced transition to individualism, large hierarchical distances, short-term orientation, poor control of uncertainties have generated the excessive focus on quantifiable short-term targets such as profits and turnover. It was also found that among other items favoured by Romanian entities as performance measurement and objective-setting tools there are included the gross margin, operating result, EBITDA (increasingly common), rates of return, costs of production, turnover growth rates, ROI (rarely). Also, there is still no attention granted to analysing budgets, deviations, and therefore many issues remain uncorrected and are propagating. An increasingly frequent is the influence of some management accounting instruments imported from the Anglo-Saxon cultures on the objective-setting process. The

implementation methods and assimilation processes erode much of these instruments' effectiveness. The aspects related to the implications of the human factor in implementation processes are ignored, and an intense endeavour of becoming familiar with the behavioural manifestations is quite absent.

## Conclusions

It is continuously demonstrated that the impact of culture on managerial accounting systems can be very strong, and the general conclusion is that the objectives of entities in different countries vary considerably. A management accounting system is inevitably placed in a specific cultural context. Some instruments are considered so harmless that their implementation does not seem to require a specific cultural environment. Others seem to produce effects only if a certain mentality is in place. In the context of our research it was stated that different countries or areas focus on different

accounting tools. Before deploying an instrument in a foreign environment, it is necessary to perceive and assimilate the cultural characteristics and the organizational mind-sets of that environment. The transplantation of any instrument must consider a variety of factors that may not be present in all contexts, organizational characteristics and, not in the least, relevant social issues. In each new environment, the anticipated benefits of implementing a particular instrument should be reviewed continuously.

Awasthi, Chow and Wu (1998) revealed that the differences in national culture may not represent insurmountable obstacles to the import and export of management accounting tools. Rather, the individuals have self-understanding and resourcefulness and can take steps to become flexible and adapt to the requirements of the new management practices and professional environment. Harrison and McKinnon

(1998) requested that, in the context of intercultural research, the cultural “drugging” of the relationships between culture and behaviour be denied.

Fundamentally, the consciousness of actions and human behaviour must be emphasized, as well as the ability of individuals to reason on multicultural, personal and contextual factors and to act deliberately in the complex interaction of these factors.

Any process of implementation should consider the magnitude of the changes in mentality and culture required from the persons involved. Implementation should not be done by hierarchically imposing the adopted decisions, with an emphasis on the daily input of each individual. A new system that is not accepted and assimilated properly is sentenced to extinction. The training effort must be oriented towards the change in mentality, rather than to the presentation of techniques.

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# Financial risk identification and control of cross-border merger and acquisition enterprises

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## Abstract

Mergers and acquisitions (M&A) are basic channels for modern companies' growth. With globalization speeding up, multinational companies increasingly take on M&A activities to strengthen global market positions and raise competitiveness. In recent years, M&A activities have played an important role in Chinese companies. Financial risk is inherent to M&A processes in cross-border companies. Also, more than 50% of Chinese companies did not achieve their M&A goals. Therefore, recognizing and controlling financial risk is essential. This paper analyses the financial risk from different perspectives and then provides suggestions by analysing a typical M&A case: Bohai Leasing merger with Seaco Company. Complete due diligence and clear M&A strategies, combination of various financing instrument, strategic paying methods and finance integration are some ways for controlling and decreasing finance risk.

**Keywords:** Financial risk, cross-border M&A, Dupont method, mechanisms of financial management.

**JEL Classification:** M14, M16, O16.

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## Introduction

Until November of 2015, Chinese companies have finished 581 cross-border M&A projects achieving a annual growth of 19.55% (PwC, 2016). The total amount of transactions is approximately \$93.7 billion, an increase of 20.9% (PwC, 2016). However, financial risk exists in the whole M&A process involving cross-border companies. China's mainland companies M&A with overseas firms increased by 40% in 2015 (PwC, 2016). Therefore, the manner in which financial risks such as pricing, financing, paying and integration are recognized and controlled has an essential significance. Complete due diligence and clear M&A strategy contribute to the decrease of pricing risks; combining various financing instruments helps to decrease fund-raising risk; strategic paying method is useful to hedge the risk of payment; financial integration, associated with business and human resources integration is conducive of lower integration risk. Bohai Leasing limited liability company became the largest container leasing company in the world after M&A activities. The merger between Bohai leasing and Seaco company has a significant meaning in itself, being representative for the international leasing market. Therefore, we selected the merger of Bohai Leasing M&A and Seaco Ltd. as an example to illustrate the study.

## 1. Literature review

Before the financial crisis in 2008, companies sought M&A projects for a variety of purposes such as market position and efficiency (Andrade, Mitchell and Stafford, 2000). However, studies show that the primary motivations for M&A activities have changed after 2009, being replaced by the purchase of advanced technologies and the exploration of new business opportunities outside of the company's primary business environment, as a response to global competition and technological changes (Lee and Lieberman, 2010; Stettner and Lavie, 2014). Unlike M&As involving companies in the same country, cross-border M&A activities face more uncertainty, including political, economic and cultural uncertainty. All have significant financial impacts. The approach regarding the financial risk is different, depending on various academic traditions; until now, no unified definition of financial risk has been established. Some authors only study M&A risks from an general perspective (Hongyanshi, 2003).

Bruner (2005) puts forward a risk analysis framework and a qualitative analysis method which balances risk levels from six perspectives: complex, connected, the abnormal case, subjective, management choice and team flaws (Calandro, 2008). The intensity of the relationship among these aspects influences the M&A risks. As to the study on the influence of financial risk of M&A, Alope and Prem (2000) state that cross-border M&A activities have a negative influence on the acquirer's financial ability and credit capacity. When referring to risk evaluation and control, Perry and Herd (2004) concluded that an efficient expert research conducted before the M&A would lower the risk. Weaver and Weaton (2003) thought that the stock exchange would solve the problem of pricing uncertainty for the target firm. Quantitative and qualitative methods are the basic methods for evaluating the financial risk. Multivariate risk measures have already been introduced by Prékopa (2012), where the concepts of Multivariate-Value-at-Risk(MVaR) and Multivariate-Conditional-Value-at-Risk(MCVaR) are introduced and explored. New methods for numerical calculations of these concepts are presented by Lee and Prékopa (2013).

Chinese scholars also make progresses in studying the risks of M&A activities since the 1980s. Target firm pricing, financing, liquidity and paying of debt, as part of the leverage effect are the basic risks of M&A (Zhiqun Ai, 2001). In terms of identification, Chen and Ai (2002) propose the selection of a suitable model for the pricing of the target firm to lower the pricing risk. Hongyan Shi (2003) believes that increasing future cash flows will lower the paying of debt risk. Shue Yang (2012) pays more attention to the integration after the M&A. As to the method to evaluate the financial risk, Haoshuang et al. (2009) use studies of M&A in the USA to analyze the financial risk from a practical point of view. Other authors analyse the financial risk mainly by using the case study method and the Dupont method (Gao, 2012; Chen Chuanxing, 2014).

From the above it can be noticed that the existing research emphasizes the theoretical study of the financial risks, from the perspectives of pricing, financing, paying and integration. Specific empirical analyses of financial risks associated with cross-border M&A, based on combining quantitative and qualitative methods are relatively rare. Besides, the precautionary measures to control the financial risks are mere

general suggestions, the integrated and operable measures are still not clear. Therefore, this paper analyses the financial risk of cross-border M&A through a case study. Specifically, it analyses the merger of Bohai Leasing Ltd. with Seaco Ltd. on September 27, 2013, it offers suggestions to control the financial risks and provides a learning experience for cross-border acquirers.

## 2. Research methodology

The research methodology selected for this study is based on the Grounded Theory. Typically, any study will employ both quantitative and qualitative tools to assess scientific issues, social sciences often using case studies (Ye, 2008) to approach these issues. However, some scholars question this method in favour of a more quantitative approach based on statistics and figures. The Grounded Theory by Glaser and Strauss (1967) tries to solve this issue, by using phenomenon observation and then comparing it to basic data in order to get to its core issue; finally, results are obtained by creating relationships between the studied concepts, thus rendering data analysis meaningful to the case research.

Miles and Huberman (1994) demonstrated that the process of original data analysis consists of three steps:

- Data extraction;
- Data explanation and;
- Data extension.

They emphasize that the analysis should be backed up, so that others can repeat the tests.

This paper combines the Grounded Theory with data analysis methods to describe the case of the Bohai Leasing M&A. Further quantitative and qualitative analysis of the financial statements gives a clearer insight into this typical M&A case.

## 3. Finance risk of cross-border M&A firms

The financial risks of cross-border M&A are generated by improper financing activities that lead to the deterioration of the financial situation, even losses. They mainly relate to pricing, financing, paying of debt and integration processes.

### 3.1. Pricing Risks

After the acquirer selects the target firm, it is essential to evaluate whether the firm's value has a significant impact on the M&A cost. The target firm's value depends on the projected future value. However, there are some uncertain elements associated with the future activities, which lead to pricing risks. Information asymmetry is only one type of risk. Acquirers get the information from the financial statements; however, the target firm could hide some negative information such as pending litigations, guarantees, and natural disasters, in order to raise the price. Also, the price of securities is an important factor during pricing. Furthermore, capital market uncertainty can cause share prices to fluctuate, bringing further obstacles to the pricing process (Sun and Ying, 2010). Another reason for pricing risk is that the price evaluation method and model are sometimes inadequate. In some countries, only few companies provide services for cross-border M&A activities. Many companies engage in M&A by themselves, lacking experience in the field.

### 3.2. Financing Risks

M&A activities need large amounts of liquidities to support the exchange of equity. Acquirers raise funds from the market (to a small or large extent) to ensure that the transaction is accomplished. Depending on the source of funding, the financing risk includes the risk associated with internal financing, from liabilities (debt) and equity. Internal financing depends on profitability. If, for example, the acquirer focuses too much on internal financing sources, it may not be able to respond adequately and adapt to changes from the outside environment. Additionally, the liquidity risk is also influenced by the normal operations (Sun and Ying, 2010). Therefore, financing by debt is the common funding method for western countries. Compared with internal financing, debt financing not only involves the obligation to pay back the principal (debt) and the interest at regular intervals. Besides, the acquirer has the obligation to pay back the target firm's debts. If the capital structure has a large debt content, the acquirer maybe fall into the debt trap. Equity financing is also a usual instrument to finance M&A operations. If the acquirer issues shares to obtain funding, it is burdened by the risk of stock dilution, which may result in losses for the shareholders. Different from

debt financing, equity financing implies greater costs. Using too much equity to finance M&A operations not only cause higher M&A costs, but it also increases the average financing costs for the acquiring firm.

### 3.3. Payment Risk

Payment risk exists in the paying process. Whether the payment method is suitable or not, it has a close relationship with M&A success (Sun and Ying, 2010). Payment methods affect several aspects of the financial statements. First, various payment methods have different influences on tax avoidance. Second, accounting will be affected. For example, accountants use the purchase method when paying cash; in the financial statements subsequent to the merger there will be found goodwill and a lower profitability. When the payment is based on equity instruments, the accountants will use the equity method to prepare the financial statements, and there is no need to write-off goodwill costs. Leverage paying method relies on the future cash flows of the target firm, but the uncertainty of negative events will inherently increase the payment risk. Third, the fluctuation of interest rates and exchange rates will further add to the payment risk.

### 3.4. Integration Risk

In order to be able to control the merger and acquisition process, and to finance a unified management, the acquirer must integrate financial management mechanisms, human resources and all other systems of the target firm. However, incompatible finance systems of the target firm will raise the integration risk. The failure of financial integration reflects in the financial statements, and can lead to a decrease of the debt-to-equity ratio (long-term solvency) and the liquidity ratio (short-term solvency).

## 4. Mergers and acquisitions. Case study of the Bohai Leasing merger with Seaco

### 4.1. M&A Background

This paper selected the Bohai Financial Investment limited company (Bohai) and Seaco M&A as a research

sample case. Bohai Financial Investment limited (Bohai Leasing) is a Chinese company and the world's largest container leasing operator. The main business of Bohai is financial leasing, aircraft advance financing (official website), mortgage financing and other six related businesses. Its largest shareholder is HNA Capital limited company. According to research, HNA Capital is a subsidiary of HNA Airlines Group. HNA Group Co Ltd., headquartered in the PRC, is a conglomerate with subsidiaries engaged in air transportation, logistics, shipping, hotel investments, financial services, tourism and other related businesses. HNA has more than 100,000 employees and is one of the largest non-government owned companies in the PRC. In fact, HNA Group is the controlling shareholder of Bohai Leasing. Since it was listed at the Shenzhen Stock Exchange in 2011, Bohai Leasing's businesses have grown gradually, company's assets, revenues, profits grew drastically, and it has become the largest company in the container sector.

Seaco was formed in 1998 as a 50/50 joint venture between General Electric Capital Corporation and Sea Containers Ltd. Seaco is a subsidiary owned by Global Sea Containers Ltd (GSCL), a Bermuda company. Seaco is the sixth biggest container leasing company in the world. It owns and manages more than 1.1 million TEU standard containers. Seaco provides, for lease and sale, a wide variety of standard and specialised intermodal container equipment, located for immediate delivery from strategically placed depots worldwide.

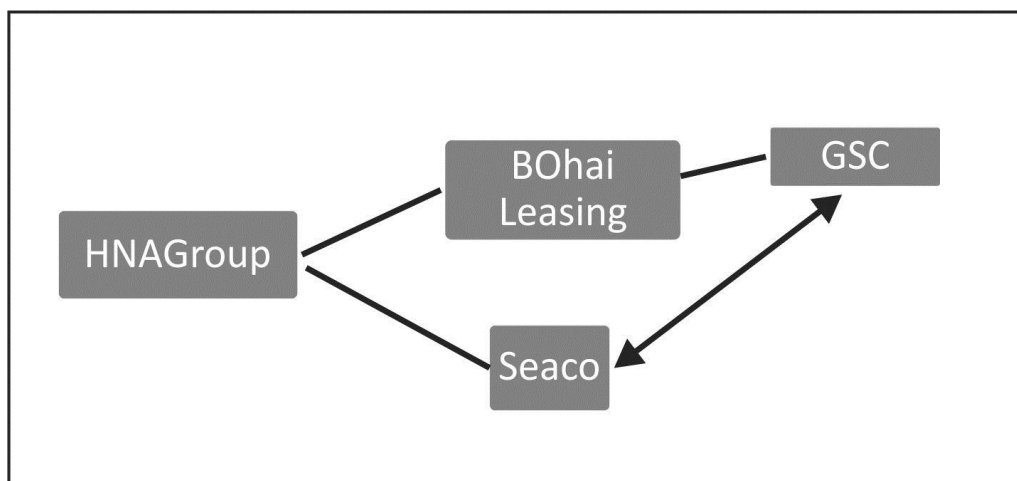
On September 30<sup>th</sup>, 2013, Bohai Leasing (000415.SZ) announced its intention to merge with Seaco Ltd. The Second Extraordinary General Meeting decided to raise funds in order to buy assets, by issuing shares and cash. The restructuring plan is the following: GSCII acquires 100% of Bohai Leasing shares. GSCII is a subsidiary company of GSC. GSC is entirely-owned by Bohai Leasing. GSC, special purpose company, entirely-owned by Bohai Leasing, acquires 100% of Seaco Ltd. through GSCII, which is a foreign subsidiary of GSC (Bohai Leasing, 2014). According to the qualified evaluation report (Bohai Leasing, 2014) issued by an evaluation institution, the parties involved in the transaction determine the price for the entire Seaco Ltd. takeover to be 1.215billion dollars<sup>1</sup>, equals 8.1billion

<sup>1</sup> According to exchange rate in 27<sup>th</sup> september, 2016.  
1dollars=6.6689RMB

RMB (Chinese currency unit), paid in cash; GSCII assumes the Seaco Ltd. debt, where the cash amounts to approximately 1.79 billion dollars (7.2 billion RMB), and debt is 0.13 billion dollars (0.9 billion RMB). Until the

end of 2013, Bohai Leasing finalized the merger transaction. The relationship between HNA Group, Bohai Leasing, Seaco, GSC and GSCII is illustrated in Figure 1.

**Figure 1. The relationship between the parties involved in the M&A transaction**



Source: Authors' processing based on Bohai Leasing stakeholder relationship.

#### 4.2. The transaction result

In order to measure the results of the M&A process, we use the Dupont method to analyse the financial changes from the company Bohai Leasing. According to the annual reports from 2011 to 2015, we selected the sales margin, total asset turnover,

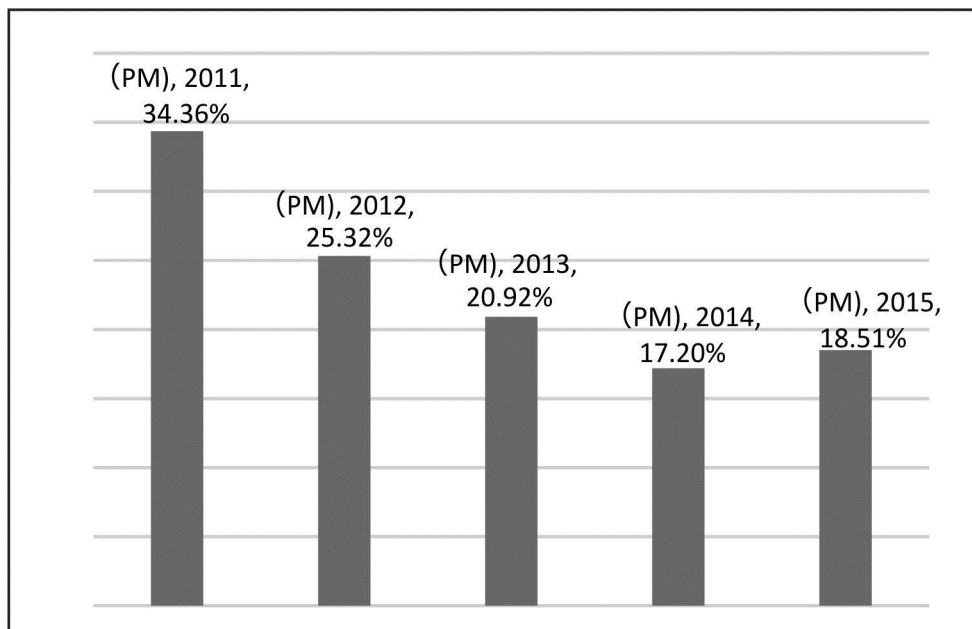
equity multiplier, ROE and other indicators, for the years before and after the M&A happened, as shown in Table 1. We noticed that ROE has a downward trend. The net profit margin on sales (net profit to turnover ratio) fluctuates: at first, it decreases and then it has an upward trend.

**Table 1. Indicators before and after the merger with Seaco**

Year	Net profit margin on sales (PM)	Total assets turnover (AU)	Equity multiplier (EM)	Rate of return on common shareholders' equity (ROE)
2011	34.36%	10.74%	2.18	5.32
2012	25.32%	10.25%	3.13	5.69%
2013	20.92%	14.64%	6.81	7.96%
2014	17.20%	10.98%	5.38	10.65%
2015	18.51%	9.68%	4.05	12.28%

Source: Authors' processing based on Bohai Leasing Annual reports from 2011 to 2015.

**Figure 2. Net profit margin on sales**

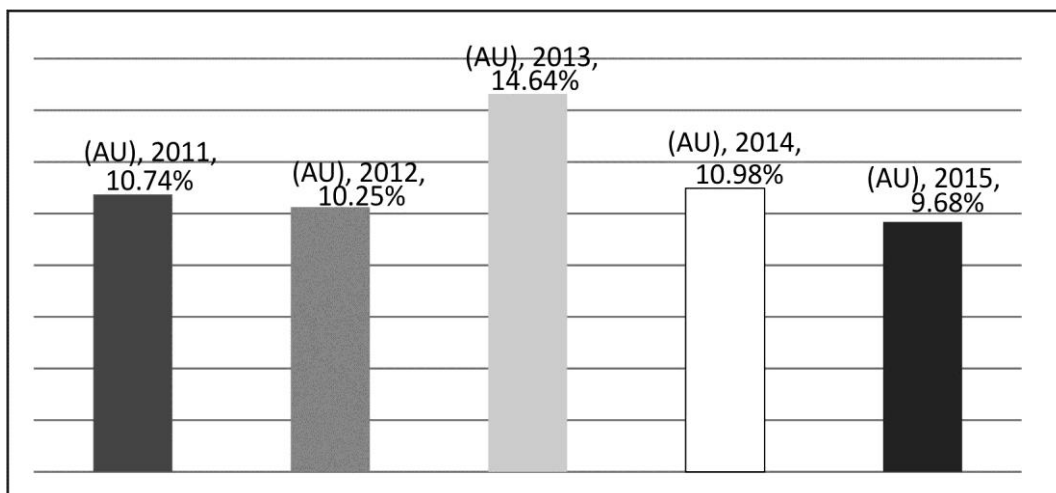


Source: Authors' processing based on Bohai Leasing Annual reports (from 2011 to 2015)

As it can be seen in **Figure 2**, the net profit margin (PM) shows a downward trend, reaching its lowest level at 17.20% in 2014. Before 2013, the PM of Bohai Leasing lowered gradually. After the merger with Seaco at the end of 2013, the PM appeared to stabilize in 2014 and

started to increase in 2015. The net profit from sales ratio is determined as the ratio of net profit to turnover . Greater PM value indicates better operating results and increased profitability. PM values indicate that Bohai Leasing has good operating results and profitability.

**Figure 3. Total assets turnover**

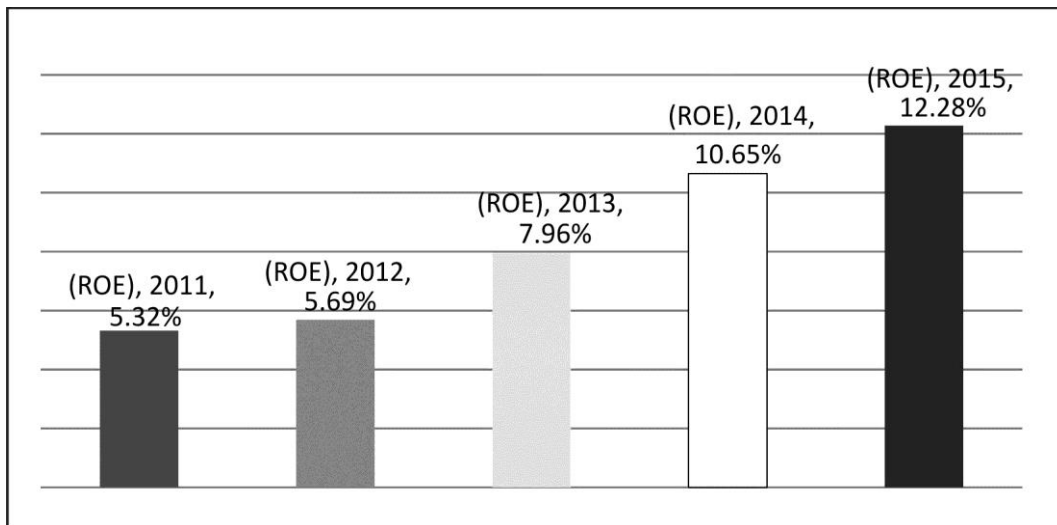


Source: Authors' processing based on Bohai Leasing Annual reports from 2011 to 2015.

According to **Figure 3**, the total assets turnover of Bohai Leasing shows an upward trend from 2011 to 2013, and then it gradually decreases year after year. Since the total assets turnover reflects the companies' ability to use their own assets in order to increase sales, the larger the ratio, the stronger the company's business

operating capacity. After the M&A, the total asset turnover did not increase. On the one hand, this is caused by the fact that Bohai Leasing used its own assets for the M&A, which shows that the business integration has affected the growth of revenues from sales.

**Figure 4. Rate of return on common shareholders' equity (ROE)**



Source: Authors' processing based on Bohai Leasing Annual reports from 2011 to 2015.

The profit to net assets margin is the percentage of net profit corresponding to the average level of shareholders' equity. This ratio reflects the level of profit over the value of equity, and it is used to measure the efficiency of a company that is using its own capital. The higher the value of the ratio, the higher the income from the investment. The ROE of Bohai Leasing shows an upward trend since 2011, demonstrating that its ability of using its own assets has increased.

After completing the acquisition of Seaco, Bohai Leasing has already increased the efficiency of its activities, with the current container rental rates growing steadily. Until now, Bohai Leasing has set up branches all around the world, in more than 80 countries on 6 continents. In 2015, Bohai Leasing issued 1.5 billion RMB in corporate bonds. Both bonds and debt hold a credit rating of AA+. The entirely-owned subsidiary Seaco Ltd. issued 10-year securities of \$500 million, backed by assets, in August of 2014, acquiring an A credit rating from Standard & Poor's and DBRS rating

companies. In 2015, the operating income reached the value of 9.659 billion yuan, an increase of 40.97%; the operating profit of 1.841 billion yuan recorded an increase of 49.21%. In 2014, the company obtained revenues of 6,851,955,000.00 yuan, an increase of 7.46 percent as compared with 2013. Due to the increase recorded by Seaco and the upward trend of its revenues, Bohai Leasing changed the value of its impairment loss related to finance lease receivables from 1.5% to 0.5%. All these show that the merger between Bohai Leasing and Seaco was successful.

### 4.3. Financial risk control and management of Bohai Leasing

#### 4.3.1. Development strategy

Before the Bohai Leasing and Seaco merger, Bohai Leasing's main customers came from China. With competition of rental business on the home market

becoming more intense, Bohai Leasing needed to strengthen its market position in order to raise competitiveness. However, the costs of expanding to new overseas markets are extremely high. The group of experts from Bohai Leasing adopted a strategy to explore the overseas markets. The experts selected several companies as target firms and performed in-depth research regarding those companies. Seaco is the sixth largest leasing company in the world. It is experienced in operating leases and management. Seaco has good prospects for making profits. In terms of its container occupancy rates and return rates, it is an industry leader. By the end of 2012, Seaco Ltd. held assets of over \$2.5 billion, with a total revenue of nearly \$500 million, and a net profit of nearly \$90 million. According to the audit report, the projected net profit values ranged between 95,995, 92,473 and 101,838 million dollars, respectively, from 2013 to 2015 (Bohai Leasing, 2015). The projected value of Seaco was 12.24 billion dollars (81.63 billion RMB). The general conclusion was that the Seaco merger could help achieve complementary goals. The thorough research and correct development strategies contributed to effectively controlling the decision-making risk during the cross-border M&A. At the same time, due to the specialized CFO and group of experts, the audit quality was promoted and the risk of uneven information spread was avoided.

#### **4.3.2. Various funding channels**

Cross-border M&A activities require extremely important support in terms of funding for the acquirer. A reasonable capital structure of the sources of funding could provide powerful support. Bohai Leasing used proactive debt instruments to raise funds from the internal and external capital markets, bond market and interbank market, by combining direct and indirect financing methods, actively following the trend of market financing, and gradually establishing long-term stable market, thus securing financing mechanisms. Bohai Leasing issued shares and used its own assets to pay the merger price. On December 27<sup>th</sup>, 2013 Bohai Leasing issued 216,450,216 shares to HNA Group to pay the price of buying Seaco. Meanwhile, it issued 81,745,000 shares, 134,770,000 shares and 72,085,288 shares to Hua An Fund Management Co., Ltd., Manulife TEDA Fund Management Co., Ltd and Tianhong Fund Management Co., Ltd., respectively, to purchase

Seaco's assets (Bohai Leasing, 2014). The issue price was 6.93 yuan/share, a total of 3.5 billion RMB. Bohai Leasing paid cash indirectly to Seaco through its subsidiary GSCII. In 2014, Bohai leasing replaced its own cash through debt financing to HNA Group, assuring liquidity (Bohai Leasing, 2014). For a firm, if the proportion of debt to capital is too high, it will bring debt service pressure and a significant decrease in financial leverage. If the equity capital ratio is too high, it will dilute shareholder value and damage the interests of shareholders. Bohai Leasing combined internal financing, debt financing and equity financing to merge with Seaco.

#### **4.3.3. Selecting reasonable payment strategies**

Interest and exchange rate fluctuations will cause the merger cost to change. Until now, banks were the main financing channels for Bohai Leasing (Bohai Leasing, 2015). Interest rate fluctuations have a greater impact on company costs. Bohai Leasing expands its financing channels, especially to external financing. For example, Seaco issued 10-year asset-backed securities of \$500 million (Bohai Leasing, 2014). On the other hand, Bohai Leasing established a financial department to manage the financial asset, such as investments in financial hedging products. So far, Seaco assets are dollar-denominated; the dollar exchange rate fluctuations will directly affect the RMB value of the company, with further impact on the company's overall performance. Responding to the exchange rate risk, Bohai Leasing held a meeting on December 5<sup>th</sup>, 2014, announcing that it actively manages the asset-backed securities. When referring to the payments in the M&A activity, Bohai Leasing designed a trading strategy to block the exchange risk. The parties involved in the transaction signed a contract regarding the settlement date. Before that date, the payments will be made using a certain exchange rate; otherwise, the price will be higher.

#### **4.3.4. Integration strategy**

The acquirer needs to identify reasonable cost-benefit integration solutions and choose the lowest cost, for the largest income. Meanwhile, financial integration must be finished as soon as possible, in case negative influences occur. Financial integration also needs to be corroborated with other aspects, such as human resources integration. Bohai Leasing set up a system

for the internal control of financial reporting. Fortunately, the number of accounting rules that need to be changed in the integration of the financial statements after the merger with Seaco is not too high. As soon as Bohai Leasing took control of Seaco, it has consolidated its financial statements. At the same time, Bohai Leasing absorbed Seaco's operating experience and know-how since the M&A was finalized. As a result of the M&A, Seaco opened up domestic container leasing business channels, further expanding its market and influence in China, to achieve the rapid expansion of its assets.

## Conclusions

Cross-border merger and acquisition activities are encumbered by financial risks during the entire process.

Before M&A, reasonable acquisition strategy and complete due diligence contribute to the decrease of the asymmetric information risk to further reduce pricing risk. Since cross-border M&A activities need large amounts of liquidities, single financing channels have a greater possibility to increase the financial risk. During the implementation phase, scientifically assessing the company's own financial capability and choosing flexible financing channels and designing reasonable capital structure will reduce the financing risk. Additionally, using various financial instruments in relation to the international capital could hedge the risk of exchange rates fluctuation, thus reducing the payment risk. In order to reduce the risk of financial integration, special attention should be granted to the integration of the business strategy and the financial system, in the integration phase.

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# Editorial

## Audit Financiar Journal

For the editorial board of the journal Audit Financiar, 2016 meant a constant concern for internationalization. In January I changed the journal's web page, the text presentation, the articles' template and the assessment form. We uploaded all the articles published in previous years. The website of the journal allows the transmission of the articles by this platform. Also, items that have already been published can be searched by various criteria. Due to new functions of the website, this year we managed to index the journal in several international databases.

At the beginning of the year the journal was indexed in four international databases: Cabell's, EBSCO, ProQuest and Ulrichs. During 2016 we focused on, for example, journal indexing in databases that allow automatic upload of information provided by the representatives of the journal through XML files (such as DOAJ or RePec). Thus, we avoided the errors of information retrieval made by people who do not speak Romanian. We indexed the journal in the following new databases:

1. Academic Keys;
2. Deutsche Zentralbibliothek für Wirtschaftswissenschaften;
3. Directory Indexing of Research Journals;
4. DOAJ;
5. ERIH PLUS;
6. Global Impact Factor;
7. RePec.

On December 29, 2015 we applied for indexing in Scopus database.

We created an account on the Google Scholar platform for monitoring the citations. We searched for articles from previous years in order to calculate correctly the scientometric indices. Now we have a Hirsch index of 7. We consider that it is very important to be able to calculate such indicators and to attract increasingly better articles as the values are improving.



Schimbați fotografia

### AUDIT FINANCIAR

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Indexuri pentru citate	Toate	Din 2011
Referințe bibliografice	258	246
h-index	7	7
i10-index	5	5



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<input type="checkbox"/>	Motivații și consecințe ale adoptării IFRS: percepții privind factorii instituționali din mediul românesc			15	2011
	I Ionascu, M Ionascu, L Murteanu				

In February we made a partnership with CrossRef. CrossRef assigns a unique identification code to the articles published in the journal. With its help the articles can be found even if the website of the journal is changing. In addition, CrossRef offers other services such as Cited by Linking (which provide for the creation of a link to the articles cited in the journal or citing articles published by us) and access to anti plagiarism software. We have already implemented Cited by Linking and iThenticate.

We have introduced anti plagiarism checking for all items received for evaluation.

We partnered with five international conferences to increase the visibility and the number of articles received by the journal. The conferences are:

- International Scientific Conference “Accounting and Finance – the Universal Language of Business”, first edition, held in Pitești, March 18 (<http://www.univcb.ro/p-168->

[conferinta3a.ase.ro/interne/interne2016.html](http://www.conferinta3a.ase.ro/interne/interne2016.html));

- International Scientific Conference “Paradigm of the Accounting and Auditing: National Realities, Regional and International Trends,” V edition, Chișinău, April 1;
- International Scientific Conference “Accounting and Management Information Systems”, the eleventh edition, held in Bucharest from 8 to 9 June (<http://www.cig.ase.ro/amis2016/>);
- International Scientific Conference “Accounting and Auditing Perspectives”, the third edition held in Timișoara on 20-21 October ([www.aapconference.ro](http://www.aapconference.ro));
- International Scientific Conference “Globalization and Higher Education in Economics and Business Administration”, ninth edition, held in Iași 20-23 October (<http://www.fea.uaic.ro/geba/>).

The situation of the articles received and published is as follows:

Issue	Number of articles published	Of which, articles with foreign authors	Number of articles rejected
1	5	0	0
2	5	0	1
3	6	0	1
4	5	2	1
5	5	1	11
6	6	1	3
7	5	1	3
8	5	1	2
9	5	1	4
10	5	0	0
11	5	3	2
12	5	2	1
Total	62	12, representing 19% of the articles published	29, representing 32% of the articles received

The articles were rejected because the originality percentage was lower than the one agreed by the editorial office, because the article is not in the journal’s area or following the rejection by the evaluators.

We worked a lot on how to present the articles. For example, we changed the system of writing the references. We adopted the Harvard system and kept citations’ consistency in all the issues published this year.

For the next period we intend to comply with all the requirements for indexing in the Thomson Reuters database.

One of the changes that will be made in 2017 will be the involvement of foreign teachers in the review process. In 2017 the journal will be published quarterly, i.e. in February, May, August and November. We look forward to receiving your articles continuously.

All the achievements in 2016 were made possible thanks to the support enjoyed by the Audit Financiar journal. First, the financial support of the Chamber of Financial Auditors of Romania (CAFR) was indispensable. Also, the autonomy granted to the editor by was absolutely necessary CAFR to publish a quality journal. Secondly, we thank the authors who trusted and sent articles to our editorial staff. On the other hand, publishing articles received from foreign authors in Romanian would not have been possible without the team of translators: Cristina Circa, Ștefana Dima, Mihaela Dumitrașcu, Raluca-Gina Gușe, Dragoș Măngiuc, Ioan-Bogdan Robu. Also we thank those who are part of the scientific council of the journal and helped us with advice whenever it was necessary this year. Our thought goes to the academics we worked with every month, the reviewers: Alina Almășan, Veronel Avram,

Daniel Botez, Ovidiu Bunget, Carmen Giorgiana Bonaci, Daniela Artemisa Calu, Vasile Cardoș, Cristina Circa, Ionela Corina Chersan, Tatiana Dănescu, Sorin Domnișoru, Alin Dumitrescu, Nicoleta Farcane, Liliana Feleagă, Niculae Feleagă, Iuliana Georgescu, Camelia Hațegan, Emil Horomnea, Ionel Alin Ienciu, Nicoleta Maria Ienciu, Ion Ionașcu, Elisabeta Jaba, Cristina Lidia Manea, Dragoș Măngiuc, Mihaela Mocanu, Marilena Mironiuc, Ana Morariu, Ioan Bogdan Robu, Victoria Stanciu, Georgeta Șpan, Aurelia Ștefănescu, Alexandru Țugui. Last but not least, we thank the readers who, according to our statistics, were very numerous.

*Respectfully,*

The editorial board of  
the Audit Financiar journal

Camera Auditorilor Financiari  
*af*  
din România



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