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**Romania's Accession to the European  
Union in 2007: Implications for Small  
Business and the Accounting Profession**

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## **Romania's Accession to the European Union in 2007: Implications for Small Business and the Accounting Profession**

### **Abstract.**

Romania's primary claims to fame have been as the home of Vlad Tepes, the warlord on whom the character Dracula was based, and for the 1989 revolution that led to the downfall of the president, Nicolae Ceausescu. Romania is now emerging from its history as a hard-line Communist country, and its citizens are hopeful of a bright new future as members of the European Union (EU).

This paper discusses the changes that have taken place in Romania recently, particularly from the perspective of opportunities for SMEs and the accountants who advise these enterprises. On January 1<sup>st</sup> 2007, Romania was granted membership of the EU. This event has marked a tangible move from the old Communist system to a more market-oriented society. Romanians are looking forward to a better standard of living, to being a part of a bigger business community, and Romanian small businesses are preparing for the changes that EU membership requires. This paper questions whether the opportunities presented by these changes have been fully appreciated by Romanian accountants, and discusses the likely impacts of these changes on the development of the accounting profession, and its relationship with SME clients.

## **Introduction**

On January 1<sup>st</sup> 2007, Romania joined the European Union (EU). This move has created an atmosphere of expectation in the business community. The path to being accepted into the EU has been a long one. Romania originally applied for entrance in June 1995. More than four years later, in October 1999, the European Commission (2006) recommended starting accession negotiations with Romania. Romania was denied entry in 2004, largely owing to problems of widespread corruption. The country has undertaken to take a hard stance against corruption as a condition of its entry, even accepting assistance from Scotland Yard to overcome the problem (Tendler 2006). Membership of the EU is anticipated to provide great opportunities for Romania to grow, affording its citizens a far greater standard of living (Condon and Troev 2007; Folcut 2006; The Independent 2007; Pawlak and Winfrey 2007).

Since Romania embraced Capitalism, there have been moves to assist entrepreneurs to set up their own businesses. The move from a communist to a capitalist system presented many challenges. After the fall of Communism the process of economic restructuring was particularly complex, yet extremely important in order that Central European countries could transform themselves from Socialist to market economies (Rondinelli 1994). Under the Communist system, some Romanians chose self employment, so small businesses existed, but the structure of the tax system made it difficult to make more than a basic living. Thus, there was no real incentive to embark on any business venture. Businesses were run in order that the owner could provide for his/her family but there was little prospect of making a substantial profit; the progressive tax system, and a variety of direct and indirect taxes prevented business owners from making substantial profits. Since this time, the government has introduced several incentives to encourage small business entrepreneurship, including sweeping tax reforms and the introduction of business advisory services (Government of Romania 2005).

## **Accessing the EU**

The Commission of the European Communities prepared a report on Romania's progress towards accession, published on 26 September 2006. The report examined

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the political and economic reforms undertaken by Romania to meet EU requirements as well as its implementation of the *acquis communautaire*, i.e. the legal order of the European Union to be respected by each and every Member State. The report confirms that Romania continued to make sustained progress in fulfilling the obligations of membership (European Commission 2006). It has adopted key legal acts to sustain the on-going reform of the justice system and the fight against corruption. Investigations into allegations of high level corruption have increased in number, and two national campaigns have been started to raise awareness among the public, and civil servants in particular, of the negative consequences of corruption (European Commission 2006).

Romania has reached a considerable degree of alignment with the *acquis communautaire*. In particular, it has taken decisive actions to meet accession requirements in areas such as taxation IT systems, the reinforcement of the administrative capacity of the institutions responsible for structural funds, environment-related issues, and fortifying the Romanian police to facilitate the fight against organised crime (European Commission 2006). In accordance with article 31 of the Accession treaty, Romania will benefit from €50 million in financial assistance in its first year to boost its capacity to enforce EU rules (European Commission 2006). The concerns regarding the costs of transition will be somewhat offset by this aid.

Romanians are expecting EU membership to give them a higher standard of living. Membership of, and participation in, a large, powerful market leads to more stability, prosperity, economic development, and more foreign investment (BBC News 2006). The European Commission's constant monitoring of Romania will make the government more accountable for its actions than in the past (BBC News 2006), which is a welcome outcome given the country's history of human rights abuses during the communist regime.

The compliance costs associated with EU membership seem to outweigh the advantages of joining but many of the drawbacks are short-term. For example, once Romania's infrastructure is improved, and higher safety standards are enforced,

Romanian citizens will benefit from the changes, notwithstanding the initial costs. The initial disadvantages will become advantages in the form of improved standards of living and better services.

### **Implications for SMEs**

From a business perspective, Romania's accession into the EU is expected to result in greater competition (Nine O'clock 2006). Romania will have to prove its competitiveness in comparison with other emerging countries (Folcut 2006) in order to enjoy international growth. EU membership may have a negative impact on ill-prepared companies, which may not be able to adjust successfully (Folcut 2006). Costs associated with necessary improvements to Romania's infrastructure will affect Romania's economy, as will the costs associated with addressing widespread corruption, adopting International Financial Reporting Standards (IFRS) and other EU regulations e.g. food safety standards will impact negatively upon certain industries (Folcut 2006)

The Prime Minister, Calin Popescu Tariceanu, is not perturbed by the prospect of failing SMEs, stating that 'developments ... indicate that small and medium sized Romanian companies are adjusting....consolidating their positions, they will have no problems in the post-accession period (Balan 2006, p.1). However, he acknowledged that there would be problems to be overcome during the transition period.

A significant change for Romanian businesses will be the necessity to adopt International Financial Reporting Standards. The EU regulation requiring the use of IFRSs by all listed companies in their consolidated financial statements became applicable on accession to the EU. Until joining, Romanian legislation required only large organisations to do so. International Harmonisation will change tax legislation and financial reporting requirements (CECCAR 2006), and these may have a flow-through effect on SMEs, and produce an increased compliance burden.

### **Implications for Accountants as SME Advisors**

Several studies have found that public accountants are usually the major source of external advice for small businesses, and that businesses using Management Advisory

Services (MAS) from public accountants outperform those that do not (Potts 1977; Kent 1988; Talty 1995). Providing that this information is effectively communicated to small business in Romania, Romanian accountants are likely to be sought after to provide MAS to entrepreneurs, most of whom will have limited business experience.

The Romanian accounting professional association, CECCAR<sup>1</sup>, has 56,000 members, almost 23,000 of whom work in public practice, with the remainder working in industry, trade and education (CECCAR 2005). CECCAR states in its 2005 Annual Report that it intends to take a proactive role in ensuring that Romanian accounting professionals are proficient in all areas that the market demands. Given that this market is changing rapidly as a result of Romania embracing capitalism, and subsequently joining the EU, CECCAR has an important role to play in the development of accounting in Romania. Interestingly, there is little information regarding this issue on the CECCAR website.

### **Implications of EU Membership for Romanian Accountants**

Current accountants will need continuous professional development in order that they may keep up with changing regulations and accounting processes. It is conceivable that accounting students will study for a very different qualification to the one obtained by their predecessors owing to changes in the business environment caused firstly by the move to a capitalist regime, and subsequently, EU membership.

CECCAR could have a significant role in providing the necessary CPD to existing professionals, assisting accounting academics in developing new, and amending existing, accounting subjects to meet the changing demands of an international market, and to address the issues of membership in the EU. To date, CECCAR does not appear to have tapped into these opportunities.

A search on CECCAR's website for EU-related issues proved fruitless. The most recent annual report available is dated 2005. In this report, the President of CECCAR discusses the value of contemporary Romanian accountants as business advisors, and

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<sup>1</sup> Corpul Expertilor Contabili si Contabililor Autorizati din Romania (The Body of Expert and Licensed Accountants in Romania).

the importance of continuous professional development. The association describes its role as: the provider of professional guidance, compliance recommendations, and of CPD programs; promotion of the value and quality of its members' accounting services; to consolidate the accounting profession throughout the country; and for establishing transparency and ethical behaviour within the profession. CECCAR identifies the need to secure, and subsequently maintain, the public trust as a concept that is new to the profession in Romania. Given its past problems with corruption, it is not surprising that the profession is becoming increasingly aware of the need to gain the public trust, and the inherent difficulty of achieving this task.

The report briefly discusses International Harmonisation (IH) thus:

*'the necessity of observing the national rules of integration into the European structures implies the assimilation, the adaptation, the compatibility, and the convergence with European directives and with the international standards in the field'* (Toma 2005).

The report subsequently proclaims its achievements regarding IH as having translated the International Financial Reporting Standards; the International Accounting Standards; the International Financial Reporting Interpretations Committee's and the Standing Interpretations Committee's interpretations, and various other underlying documents of the International Accounting Standards Board. These translations have been advanced as examples of CECCAR's commitment to provide guidance to its members, and as evidence of it achieving this goal.

Whilst IH is a significant issue in light of Romania's admission to the EU, other important issues seem to have been ignored, forgotten, or not recognised, and the profession is in danger of squandering many remarkable opportunities. These are discussed below.

Given that private enterprise is a relatively novel concept in post-Communist Romania, and that business is expected to benefit from EU membership, the opportunities for accountants skilled in providing MAS seem limitless. The limited

experience of business entrepreneurs, changes in reporting requirements, an increase in foreign trade, and expected market growth all suggest that professionals with a high level of competence and expertise in business strategy and management would be highly sought after and appreciated.

The EU's focus on widespread corruption in Romania may result in opportunities for accountants choosing to provide forensic accounting services. Forensic accounting services are provided in connection with court cases. There are three distinct areas: litigation support, where accountants make a written valuation on the economic loss suffered by a party and are prepared to be cross-examined in court; investigative accounting, where they seek to discover how funds were stolen or errors were made; and dispute services, where they are attached to a party in a commercial disagreement or become the mediator of a disagreement. Increasingly, forensic accountants are introducing proper controls in areas such as payroll, procurement and inventory (ICAA 2005). In addition to problems associated with corruption, Romanian entrepreneurs' inexperience may also result in the need for such services.

In addition to the lack of experience of Romanian entrepreneurs, the changes necessary to ensure that Romania complies with EU financial reporting, employment and tax requirements should place accountants in a strong position as professionals with knowledge that is invaluable to novice entrepreneurs in a rapidly changing business environment.

Conversely, the conditions that provide these opportunities also create pressures for accountants inasmuch as they need to ensure that they are conversant with this changing environment and that they maintain a commitment to continuous professional development. If they fail to do so, the opportunities outlined above could be missed.

There is an accounting skills shortage in many parts of the world (CICA, 2004; ICAEW, 2005; ICANZ, 2005; ICAA, 2005; AICPA 2005). Reasons suggested for this phenomenon include fear of being sued in the current culture of auditor liability, and the tarnished reputation of the profession making it an unattractive profession to join (American Assembly, 2003). Joining the EU may make it easier for Romanian

accountants, after appropriate training, to have their qualifications recognised in other EU countries, and it is possible that there would be an exodus of accounting professionals to other countries that promise better salaries. This would be unfortunate when so many local opportunities are available.

### **Conclusion**

Romania's economy has grown rapidly in the past few years. This can be attributed to its embracing capitalism, and the changes that it has enforced in its efforts to gain EU membership. Foreign investment is growing and is being actively nurtured. Entrepreneurs are being encouraged and supported. The atmosphere in Romania is one of hope for, and expectation of, a great future of growth and prosperity. EU membership has provided opportunities for Romanian entrepreneurs to flourish and the future looks promising for contemporary Romanians.

The accounting profession will experience many changes as a result of Romania's membership of the European Union, and the incentives that have been offered to encourage entrepreneurship and investment in Romania. These changes are likely to have a profound effect upon all facets of the profession. Both the professional accounting association and its members have great opportunities to become invaluable advisors to their business clients, and accounting academics will need to refresh the accounting curriculum to reflect changes in the business environment and to meet new market needs.

The profession's success in these areas is dependent upon it recognising the opportunities available, taking a proactive role in filling the knowledge gap, and successfully communicating its value to the business community.

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