

# THE DIRECTIVE NR. 2006-43-CE STIPULATIONS' IMPACT ON THE ROMANIAN BANK ENVIRONMENT

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*Abstract : The Directive 2006-43-CE regarding the statutory audit of the annual accounts and the funded consolidated accounts gets the power of an actual law from the moment of its inclusion in the national legislation, respectively for Romania from the end of June 2008. The banks will be between the economic entities of public importance compelled to respect this norm. The article presents some of the obligations of the bank sistem and the audit firms starting with the second half of 2008. At present we may say that our country is setting its time for adhesion to international accounting procedures by a convergence process. Bank appraisal in a competitive and volatile market environment is a complex process wich normally centers around the analysis of particular aspects, including risk profile and management, financial statements, portofolio structure and quality policies and practicies, human resources, and information capacity.*

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The Directive 2006-43-CE regarding the statuary audit of the annual accounts and the funded consolidated accounts has been published in the Official Journal nr. L 157-87 from 09.06.2006 of the European Union and it gets the power of an actual law from the moment of its inclusion in the national legislation.

The Directive 2006-43-CE replaces the Directive 84-253-CEE regarding the authorization of the persons responsible for the legal control of the accounting documents. The responsibility for transforming the directive into a law belongs to the Government through the Department of Economy and Finances, the deadline for the transformation being the end of June 2008 in Romania.

There is already a current law project regarding the transformation of the Directive concerning the statuary audit. The project can be consulted on the site of the Department of Economy and Finances ([www.mfinante.ro](http://www.mfinante.ro)), conform to the procedure of decisional transparency. According to the Directive 2006-43-CEE the banks are considered to be entities of public interest.

In Romania, the public interest entities are defined by the article 33 of the Accounting Law nr 82-1991, republished, modified and upgraded by the Law nr. 259-2007, such as:

- Credit institutions;
- Non-banking financial institutions, defined according to the legal regulations, inscribed in the General Register;
- Assurance, Reassurance and Assurance-Reassurance societies;
- Authorized entities, regulated and overseen by the Committee of Supervision Of the Private Pensions System;
- Societies of Financial Investments ;
- The juridical persons that are part of a group of societies and they enter the perimeter of consolidation by a mother-company that applies the International Standards of Financial Reporting.

The motivations for including special stipulations in case of public interest entities:

- They have a great visibility on the market;
- They present a special importance from the economical point of view;

- In the case of banks, we consider that the motivations for the inclusion of special stipulations can be extended, without limiting to:
- The high degree of exposure to a very large scale of risk;
- The enhanced sensitivity of bank's actives and passives to the circumstantial factor;
- The rapidity of receiving and dissemination of negative signals in the economy.

The member states must assure themselves that the statutory auditors and the audit firms that make the audit for the public interest entities will publish on their website, in the next three months from the closing of the financial year, an annual report concerning transparency including at least the following:

- A description of the legal structure and of the shareholders;
- A description of the network and of the legal and structural agreements of the network, when the audit firm belongs to a network;
- A description of the audit firm's leadership;
- A description of the internal systems of quality control of the audit firm and a declaration of the administrative or management structure regarding the efficiency of its functioning;
- A notification of the moment in time when the last check of quality was done, as the Directive requires;
- A list of the public interest entities for which statutory audits have been done in the last year by the audit firm;
- A declaration about the policies of the audit firm concerning the independence which confirms as well that an internal check of the way in which independence was respected has been done;
- A declaration about the policy the audit firm follows regarding the continuous professional training of the statutory auditors, respecting as well the Directive's stipulations;
- Financial information that prove the importance of the audit firm, such as the total business figures divided into fees from the statutory audit of annual and consolidated accounts and fees received from other assurance services, services of financial consulting and other non audit services.
- Information regarding the base for the partners' remuneration;

The report regarding the transparency will be signed by the statutory auditor or the audit firm, whatever the case. Directive -43-CEE has the compulsory special stipulation that every public interest entity should have an audit committee. It is left to the member states latitude the competence of this committee:

- The non-executive members of the administrative structure and-or
- Members of the structure supervising the audit entity and-or
- Members elected by the general assembly of the shareholders of the entity under audit.
- Another condition of the Directive refers to the Audit Committee's structure so at least one member of the Audit Committee must be independent and have competence in the accounting and-or audit domain. The Council of Administration has the final responsibility for the bank's activity and it has to answer to the structures of bank regulation and supervision, to shareholders, to depositors and to the public society. The Councils of Administration are compelled to chose a strategy, based on adequate policies, starting from the observation that liberalization and volatility of financial markets, the greater competition and the diversification expose the banks to new risks and challenges which bring the necessity to of continuous innovation of the manner of administrating and activity and its afferent risk in order to maintain competition.<sup>223</sup>

The responsibilities of the Audit Committee mentioned in *The Directive concerning the statutory audit* are:

- To survey the process of financial reporting;

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<sup>223</sup> H. van Greuning, S. Brajovic Bratanovic, *Analiza si Managementul riscului bancar*, Casa de Editura Irecson, Bucuresti, 2003, p.12.

- To survey the efficacy of systems of internal control, internal audit, when necessary, and of risk management inside the society;
- To survey the statutory audit of the annual, individual and consolidated financial statements;
- To verify and survey the independence of the statutory auditor or the audit firm and especially, the carrying out of supplementary services for the entity under audit process.

As far as the survey of the reporting process is concerned, the audit committee expects the statutory auditor to have the possibility of expressing an opinion upon the financial statements, therefore making sure that the bank adheres to specific format and terminology mentioned by the law, by the authorities for regulation and supervision, by the professional structure in this domain and by the practical activity of credit institution.

Another obligation of the audit committee is to survey the adjustments brought to the financial statements of the branches and offices from abroad that are included in consolidated financial statements of the bank in order to be put in conformity with the financial frame of reporting on the basis of which the bank reports in the native country. The foreign banks that have entered the Romanian can bring about some clashes of opinions on the accounting principles currently applied and the possibility of applying the reporting frame from the native country and the Romanian financial reporting frame. If the financial statements are in concordance with only one of the reporting frames, the auditor is compelled to state an opinion about the conformity with this frame, respectively the non-conformity with the other financial reporting frame.

Regarding the survey of internal control, the bank's audit committees are familiar with the COSO (the Committee of Sponsoring Organizations of the Tradeway Commission)<sup>224</sup>, which considered by a large number of professional structures and credit institution to be a real standard for the evaluation of internal control, and it is based on five component parts :

1. control environment;
2. risk evaluation
3. control activities
4. survey and learning process
5. information and communication.

The International Audit Standard ISA 315 Understanding the entity and its environment and evaluation of the risk of significant distortion, states for the financial auditor that internal control targets the following parts:

- control environment;
- the process of evaluating the risk by the entity;
- informational system, including the linked activities, which are relevant for the financial reporting and communication;
- control activities;
- surveying the control processes.

The five components parts of the COSO model are quite close to the sense International Audit Standard ISA 315 Understanding the entity and its environment and evaluation of the risk of significant distortion<sup>225</sup>, and their aim is a the existence of a good communication between the Audit Committee and the statutory auditor in order to achieve a correct evaluation of the internal control, starting from the common base of understanding the place and the role of the control in the bank management.

The Audit Committee surveys the statutory audit of the annual, individual and consolidated financial statements, its objective being the new approach oriented towards the identification and treating the domains of risk instead the traditional manner of approaching the balance and the profit-loss account.

Verifying and surveying the independence of the statutory auditor or of the audit firm, is of great importance for the banks, the proposal for the appointment of an auditor from an audit firm, made by the administrative or supervision structure, depends on the recommendation of the Audit Committee.

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<sup>224</sup> [www.coso.org.ro](http://www.coso.org.ro)

<sup>225</sup> Audit Financiar 2006 – Standarde – Codul Etic, Editura Irecson, Bucuresti, 2007, p. 131.

The statutory auditor-audit firm reports to the audit committee:

- about the important problems that are reflected in the statutory audit;
- about the significant clashes of opinions on the internal control regarding the financial reporting process.

A special compulsory stipulation referring to the independence of statutory auditors that audit public interest entities is that the Member States must assure themselves the statutory auditors or the audit firms auditing public interest entities:

- confirm annually in writing to the Audit Committee aspects concerning their independence from public interest entities;
- inform annually Audit Committee about the supplementary services made for the public interest entity;
- discuss with the Audit Committee about the threats to their independence and the protection measures made to diminish those threats.

The statutory auditor the key partner that makes the statutory audit on behalf of the audit firm is not allowed to have an important leading job in the entity under audit before the pass of at least two years from the date of the resignation from the auditor job or the key partner in the audit mission. The member states assure themselves the statutory auditors or the key partners responsible for the statutory audit are replaced periodically, in their auditing mission, after seven years at most from their appointment and they are allowed to participate again to the entity's audit process after a period of at least two years.

The survey of assuring quality like it is stated by the Directive must be made at least every three years for the statutory auditors or audit firm that make statutory audits for the public interest entities. As far as the banks are concerned the auditors will take into account The international declaration regarding the practical activity of audit 1006, created by the International Committee for Practical Activity in Audit of the International Federation of Accountants which has included surveyors on behalf of the Basel Committee on matters of bank supervision, the only objective of this declaration is to offer practical assistance to auditors and to promote a good practice in applying the International Audit Standards in the audit of the bank's financial statements <sup>226</sup>, based on the characteristics that make banks different from other commercial societies:

- Banks have for safekeeping a larger amount of currency elements, including cash money and negotiable titles; their security must be permanently assured. The liquidity of this element induces a high degree of risk expressed in an enhanced vulnerability of the bank in front of fraud and theft.
- Banks often starts transaction in a primary jurisdiction, and they are developed, administrated and finalized in other jurisdictions.
- Banks operate in conditions meant to maintain a very low report between permanent capitals and total actives, that determining a higher vulnerability in front of negative economical situation with consequences on the risk of liquidity and therefore on the risk of bankruptcy.
- The bank actives may suffer rapid changes of value, sometimes being difficult even to evaluate actives; a small decrease of the actives' value can have a significant effect on the banks' solvability.
- Banks obtain important funds from short-term deposits, which can become really volatile in certain conditions, a loss of public trust having then catastrophic effects.
- Banks have responsibilities like the trust of their clients regarding the actives; that is why operational procedures and internal controls are needed in order to make sure those actives are treated in conformity with the contract's conditions and terms.
- Banks are involved in a large number and variety of transactions for the surveying of which are necessary complex systems of accounting and internal control, the IT technology being irreplaceable.

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<sup>226</sup> Audit Financiar 2006 – Standarde – Codul Etic, editura Irecson, Bucuresti, 2007, p. 748.

- For a better coverage of the territory, banks operate through networks of branches and departments divided on geographical criteria, which implies a decentralization of authority and a dispersion of the functions of accounting and control, with the normal difficulties of maintaining a certain standard ; the situation is more complicated when the network exceeds the national boundaries and enters different jurisdiction.
- The possibility of the client to initiate and carry out transaction without the bank's employees help has increased by the use of ATM or e-banking.
- Banks accept and take upon quite frequently important commitments without an initial transfer of funds to be reflected in the active or passive balance which makes the evidence of extra balance accounts more important for the banks than for other common commercial societies.
- The bank activity is regulated and supervised by authorities, and the requirements of regulation can influence the accounting principles a bank follows, the conformity with the requirements of regulation and authorization
- The relations the audit firm through its representatives can have with the bank from the position of the client can affect the independence of auditor in a considerable manner when facilities are received, other than those offered to common clients.
- Banks have almost exclusive access to systems of compensating and payment of checks, fund transfers etc.
- Banks are connected to national and international systems of payment, being therefore vulnerable to the systemic risk in the countries where they operate.
- Banks must establish adequate procedures of evaluation and administration of risks, having work methods and instructions similar to those of the European Union. The convergence in the accounting domain will be continued by the transposition of the Directive 2006-43-CE in the national legislation. The Romanian Bank system has succeeded in a high degree to be compatible with the European bank system, the proof being the presences on the market of foreign capital banks that are already respect the international procedures. We appreciate there is sufficient experience so the banks and the financial auditors may successfully assimilate the Directive 2006-43-CE.

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