

## **Differences between the German and Romanian GAAP**

by Costina Constantin

The business environment in Romania is represented by a significant number of companies belonging to German groups or by German investors looking for business opportunities to expand their businesses in Romania. In such context the reporting of the financial performance of their Romanian subsidiaries to the parent companies should allow the investors to properly understand the results and to facilitate them in taking the best investment decisions.

In practice there are important differences between the Romanian accounting and reporting framework and the German Generally Accepted Principles (Handelsgesetzbuch or HGB). Those are shortly described below:

### **1. Revaluation of fixed assets to their fair value**

The German GAAP (HGB) does not allow the revaluation of the fixed assets, the historical cost being the main accounting principle.

The Romanian accounting and reporting framework, on the other hand, allows the companies to elect, as an alternative method, at the end of the financial year, to revalue the cost of the fixed assets recorded in the accounting records at the fair value of such assets. The fair value is determined based on revaluations normally made by authorized evaluation, in accordance with the legislation.

A revaluation reserve is set-up upon the revaluation of the fixed assets of a company, provided that the revaluation difference is positive. The Revaluation reserve is decreased upon the usage of the respective asset and upon removing of the respective assets from the companies' patrimony (sale or write-off). The Revaluation reserve cannot be distributed, directly or indirectly, unless it is realised (i.e. transferred to profit, upon gradual usage, through depreciation or upon the sale or write-off of the asset). The revaluation reserve is gradually taxed upon recording the depreciation or in full, upon the sale or write-off.

The revaluations should be made with such frequency in order to ensure that the accounting value of the respective assets should not be substantially different than their respective market value.

If the company elects to perform the revaluation of the fixed assets, according to the provisions mentioned in the text above, then the revaluation cannot be selectively applied only to some of the fixed assets items belonging to the respective category (all buildings, land or equipment should be revalued if the company elects to apply the alternative method to any of these fixed assets categories).

Recently, an amendment of the Romanian accounting and reporting framework allows the companies to revert from the revaluation method to the cost method as long as this change will not result in the value of the fixed assets recorded in the financial statement being understated.

## 2. Contributions by the shareholders

The German legislation allows the shareholders to make capital contributions directly in the reserves accounts and the shareholders can also make withdrawals from such reserves.

In Romania, according to the Companies Law no 31/1990, any contribution from shareholders must be made as an increase of the share capital of the company, either in full or with an agio. Should the issue of new share capital be made with an agio, the difference between the nominal value of the newly issued shares and their issue price is recorded in a reserve account – capital reserves – part of the shareholders' equity. The Romanian legislation does not allow shareholders to increase the company's reserves via contributions in cash without the increase of the share capital.

The Romanian legislation strictly establishes the set-up of the reserves, as part of the shareholders' equity. Legal reserves and other reserves are set-up via profit distribution. The legal reserves are compulsory for all companies and must reach 20% of the companies' share capital, with an annual distribution of 5% from the profits until the reserve reaches the 20% threshold. The setting-up of legal reserve is deductible for the corporate income tax purposes, and its usage for covering of the losses is taxable. The other reserves can be set-up voluntarily by companies as a distribution from profits, without any limit legally imposed.

No withdrawals by shareholders from any type of reserves are allowed by the Romanian legislation. The only withdrawal of the investment by the shareholders must be made in the form of a reduction of the share capital. The decrease of the share capital via withdrawal of the investment by the company's shareholders should not be implemented if the company is in a thin capitalization position. In such case the share capital should be used to cover any residual accounting loss remaining after the usage of the statutory reserves, optional reserves or capital reserves.

## 3. Corrections of errors

According to the German GAAP, the errors identified in relation to the previous reporting periods are to be included in the net result of the current period (profit or loss).

In opposition to the German approach, in Romania, such errors are to be recorded in the net result of the period they relate to, by using a specific retained earnings account.

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