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Full Length Research Paper

Is SMEs accounting influenced by taxation? Some empirical evidence from Romania

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One specific aspect of small and medium-sized entities (SMEs) accounting debated in literature is its connection with taxation. This 'connection' is not always explicitly recognized, since accounting rules are separate from fiscal ones. In practice however, these seem to interweave, as accountants usually turn also to fiscal regulations when treating transactions, providing more of a fiscal than accounting 'true and fair view' of the position of the entity (especially for the small and medium-sized entities). We performed an empirical analysis over a period of 11 years seeking evidence on the de facto relationship between accounting and taxation. We collected data from the Romanian SMEs sector, since in our country changes in accounting and fiscal regulations provide an excellent setting for analyzing such a relationship, as explained in the paper. Our empirical findings confirm that accounting is indeed influenced by taxation (de facto influence); however, the level of such influence varies across the years under observation. Furthermore, amendments in the tax and accounting regulations seem to contribute to the disconnection of taxation from accounting, but with a low force.

Key words: SMEs, accounting, taxation, Romania.

INTRODUCTION

Small and medium-sized entities (SMEs) play a very important role in the European economy and represent 99% of all enterprises (European Commission, 2004). Researching SME accounting provides many opportunities as presented by Eierle and Schönefeldt (2010). One specific aspect of the accounting of SMEs debated in the literature is its connection with taxation, especially in the context of a possible accounting convergence of national regulations with international financial reporting standards (IFRSs). This 'connection' is not always explicitly recognized, since accounting and fiscal rules may differ. In practice, however, these seem to interweave, since accountants usually turn also to fiscal regulations when treating transactions, providing a more fiscal than accounting 'true and fair view' of the entity (especially for SMEs). This might happen due to regulations (accounting rules are incomplete and/or fiscal rules are more detailed) or practice (accountants may find more convenient to comply with fiscal rules instead of accounting ones, such as fiscal amortization/ depreciation, impairment, reserves, recognition of accruals, revaluations etc).

The Central and Eastern European former communist countries (such as Poland, Romania, Bulgaria etc.) underwent several accounting reforms after the fall of communism, but the relationship between accounting and taxation is still considered by some as a characteristic of their national accounting system (Sucher and Jindrichovska, 2004; Vellam, 2004; Nobes and Parker, 2008) and an impediment towards global accounting convergence by others (Blake et al., 1997; Larson and Street, 2004). But these countries are very diverse and have different practices (Nobes and Parker, 2008); thus, research is needed in each setting in order to understand

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the national characteristics and to assess the strategy of future accounting convergence (and perhaps the implementation of the IFRS for SMEs).

In this paper we perform an empirical analysis over a period of 11 years, seeking to bring evidence on the relationship between accounting and taxation. Our data come from the Romanian SMEs sector, since in our country the numerous changes in the accounting and fiscal regulations provide an excellent setting for analyzing such a relationship. There were different stages in the reform of the Romanian accounting model, but the relationship between accounting and taxation, considered a key issue in all developing countries, was not properly analyzed. We use a model proposed by Fekete et al. (2009) to capture the fiscal influence over accounting. Our results confirm that the level of fiscal influence over accounting varies across time and it seems to be connected with changes in accounting and/or fiscal regulations.

The contribution of this study to literature is twofold. First, we provide some insight on the economic content of the accounting information of Romanian SMEs. According to our results, accounting on the SMEs level provides more ‘fiscal’ than ‘financial’ information, since SME accounting seems to be strongly influenced by taxation. This has been often alleged in the (local) literature, but never measured or documented on empirical basis thus far. Second, amendments in both accounting and fiscal rules decreased the de facto level of fiscal influence on SME accounting in the period analyzed. However, the disconnecting strength of such amendments remains relatively small. Furthermore, this is the first empirical tax research paper in Romania, and also in the Central and Eastern European (CEE) region. The model could be useful for accounting and assurance standard setters, fiscal authorities, accountants and auditors, as well as users of accounting information (investors and banks).

The paper is structured as follows: review of the relevant literature on both the international and the national level. Thereafter, we prolong the review with relevant normative sources, describing the fundamental characteristics of the Romanian accounting and fiscal regulations for SMEs after the fall of communism. Then, we lay the conceptual and methodological foundations of the research, such as the research hypothesis, the model development and definition of variables. Data management issues are discussed, followed by interpretation and discussion of the results. Finally, we conclude the paper.

LITERATURE REVIEW

There is a significant body of taxation research in accounting worldwide, many of them being published in local languages, since taxation is usually considered a local issue. Therefore, papers published in this field vary significantly by regions and languages (Anglo-Saxon countries, continental European countries for example) and also by the research methods applied (descriptive/ analytical versus empirical). Following this logic, we looked separately at the local (that is, Romanian) literature and the international body of knowledge, local literature being extended further with its normative component (as discussed later on in the paper).

The mainstream research in this field is the analytical approach, since the large majority of the papers published use analytical research tools. We focused here on both descriptive/analytical and empirical papers in taxation, in order to position our analysis among this research stream.

One important issue in international accounting studies is the degree to which taxation regulations determine accounting measurements (Nobes and Parker, 2008). The literature in this area contains studies examining the case of a country, comparative studies and taxonomies.

Country – specific studies include Haller (1992) arguing that in Germany, it is a very close interaction of financial accounting and tax accounting, the *Massgeblichkeitsprinzip* (the principle of congruence) being a significant and a specific characteristic of German accounting. Gallego (2004) analyzes the case of fiscal influences in the financial statements of listed companies in Spain. Using Austria as a case study, Eberhartinger and Klostermann (2007) advanced the idea of using IFRSs as a tax base.

Comparative studies were conducted by Blake et al. (1993), Blake et al. (1997) or Blake et al. (1998) in EU countries such as Germany, Spain and UK (the 1993 study), UK, Germany and Sweden (the 1997 study) and Spain, Sweden and Austria (the 1998 study). Some of their conclusions are that there is a major change as a result of implementation of the EC Fourth Directive (especially in Spain) and that in some countries (Spain, Sweden and Austria) tax authorities and small entities benefit from keeping the relationship, because breaking it would increase compliance costs.

As regards the taxonomies advanced for studying the relationship between accounting and taxation, an influential one is proposed by Lamb et al. (1998), who identify five possible cases. Based on this classification, the authors conducted a test on four countries, two countries with Anglo-Saxon systems (UK and US) and another two with continental European systems (France and Germany). The results confirmed a strong accounting-taxation relationship in the continental countries, most items falling in Case IV and Case V, unlike the Anglo-Saxon countries (UK and US) where most items fell in Case I.

Nobes et al. (2004) tested the classification by Lamb et al. (1998) on Spanish data, and performed a comparison between Spain and the countries included in Lamb et al. (1998) (UK, US, France and Germany). The analysis was conducted on 3 years (1989, 1994 and 2003), periods that reflect important changes in the evolution of Spanish accounting and taxation The analysis included the items that were identified and tested by Lamb et al*.* (1998), adding one more item to them (financial assets). Another change from the original Lamb et al*.* (1998) paper is the separation of Cases III in Case III and Case III†. Case III† appears when accounting predominates, still there is also some tax influence over accounting. They concluded that the assumption of a significant reduction in tax influence as a result of EC Directives adoption can be rejected. Consequently, the linkage is approximately as close now as it was before 1990. The comparative analysis among countries included in Lamb et al*.* (1998) situated Spain between Germany / France on the one hand and UK / US on the other regarding the influence of taxation over accounting.

Nobes and Schwencke (2006) apply the Lamb et al*.* (1998) taxonomy to the case of Norway and develop a classification of the accounting-taxation relationship in several stages. We consider the taxonomy of Lamb et al*.* (1998) and the inputs from subsequent studies (Nobes et al*.*, 2004; Nobes and Schwencke, 2006) for the purpose of our paper. However, studies existing in literature only treat the case of developed countries, which is useful for understanding different types of relations between accounting and taxation, but has arguably a low degree of generalizability for developing countries.

In the Central and Eastern European (CEE) region there is also some evidence concerning the relationship between accounting and taxation. For example, Pavlik (2001) used a value-relevance methodology to find that deferred taxes are not significant for share prices in case of Hungarian listed companies. Bosnyák (2003) studied in Hungary the accounting policy choices of both big entities and SMEs. His findings confirm the *de facto* impact of taxation on accounting on both levels, since in case of SMEs the strongest factor was the "taxation", explaining 26.174% of decisions made by accountants in their accounting policy choices. Furthermore, for big entities taxation qualified the second strongest factor with 15.082% explanatory power (*idem*). Based on his framework, Fekete et al*.* (2010) found also important influence of taxation on accounting in Romania as discussed later.

Some empirical studies refer to the role of taxation in the Czech Republic and in Poland. Sucher and Jindrichovska (2004) analyzed the impact of implementing the IFRS in the Czech Republic. They concluded that the attitude of state authorities was not favorable to IFRS, the close link between accounting and taxation offering footprint. In contrast, companies have demonstrated a favorable attitude, concluding that this is one of the key solutions for disconnecting tax and financial accounting. In Poland, Krzywda and Schroeder (2007) identified the causes of quantitative (for 2001 and 2003) and qualitative (for 2004) differences of financial statements between IFRS and Polish accounting regulations (PAR) for listed entities on the Warsaw Stock Exchange (WSA). Their study concludes that taxation is one of the main causes for differences between the two regulations (PAR and IFRS). Another interesting analysis was carried out by Jaruga et al*.* (2007) on the impact of IAS/IFRS on PAR for listed entities on the WSA. The authors identified the areas where significant changes have occurred in the implementation process of IAS/IFRS for WSA listed entities, concluding that in these changes taxation had an important role.

Romanian studies on the impact of taxation on accounting are based primarily on analytical methods. A major issue is the main user of accounting information in our country. Many studies advance the hypothesis that the State is the main user, especially in the case of SMEs (Berinde and Răchişan, 2005; Matiş, 2005; Albu et al., 2009; Matiş and Pop, 2010), thus, explaining the importance of taxation. Some (Paliu-Popa and Ecobici, 2007; Neamţiu, 2008) consider that this is the result of the nature of the accounting system (with characteristics from the Continental European model) and the type of regulation (the State regulates both accounting and taxation).

Others, especially the national regulator, deny the strong influence of taxation. For example, Petre and Lazăr (2006) argued that accounting regulation is not connected with taxation. They insist that in practice entities might use tax instead of accounting rules, but this pertains to practice and not regulation, and concludes that "there is no subordination of accounting to taxation and accounting rules are not harmonized with fiscal rules" (Petre and Lazăr, 2006, translation). Moreover, they underline that "such opinion that accounting serves fiscal interests represents at least not knowing the current Romanian reality" (*idem*). This seems a response to the critiques by professional bodies' (especially the Body of Expert and Licensed Accountants of Romania – Corpul Experţilor Contabili şi Contabililor Autorizaţi din România, CECCAR) which continuously criticized the strong interference of taxation in accounting, as the CECCAR's representative underlined in an interview (Albu et al., 2009) that Romanian financial statements prepared in accordance with national regulations give a fiscal image, and that accountants are paid by entities to work in the interest of the State.

The results by Fekete et al*.* (2010) contradict though the propositions by the national regulator. They provide empirical evidence on Romanian data regarding the fiscal influence on accounting. They sent out questionnaire to Romanian SMEs and asked about the level of influence of pre-identified factors on accounting policy choice of the entity. Their findings confirm previous literature debates, since the most important factor identified is *taxation,* explaining for 36.7% of the variation in the choices of accounting practitioners in accounting policy decisions.

Other authors discuss the factors affecting the relationship between accounting and taxation and its evolution. For example, Berinde (2004) analyzed the introduction of the concept of deferred (income) tax in the Romanian legislation as the early effort towards the separation of accounting from taxation. Later, Berinde (2006) considers that in Romania there is the possibility of gradually opening the way toward an efficient accounting system, in which the accounting and taxation operate independently of each other. A disconnection between accounting and taxation should be associated with a reduced rate of taxation. The consequence would be reducing the country risk and thus a more favorable country report for Romania.

By means of literature review we conclude that especially in the Continental European countries the influence of taxation over accounting is important, but the relationship takes different forms and is shaped by different factors, as different taxonomies proposed in literature suggest. In CEE countries there were several reforms in accounting and taxation and the relation between them is important in order to undertake further steps in accounting convergence. The previous studies on Romania generally support the hypothesis of a strong relationship between accounting and taxation. We will focus on the empirical analysis of this relationship after discussing the main changes in the accounting and taxation after 1990.

REVIEW OF ROMANIAN REGULATIONS

Romanian accounting regulations

The fall of communism and the transition towards a market economy represented major events that affected significantly Romanian accounting after December 1989. There were several stages of accounting reform, via several accounting regulations issued by the Ministry of Public Finances, which was and still is the accounting regulator. Several Romanian and foreign authors were interested in the changes of the Romanian accounting system (Feleagă, 1996; Delesalle and Delesalle, 2000; Roberts, 2000; King et al., 2001; Calu, 2005; Ionaşcu et al*.,* 2007; Mustaţă, 2008; Fekete, 2009; Albu et al., 2010). They analyzed from a historical point of view the accounting regulations after December 1989, as well as their historical sources of influence, which were French, British – international accounting standards (IAS), and the European Directives, respectively and chronologically. Thus, the first accounting regulations were influenced by and based on the French accounting model, but at the end of the '90 external demands for increasing the orientation towards IASs manifested (while the reform was made under British influence). After 2005, Romania's adhesion to the European Union resulted in the full enactment of EU Directives in Romanian legislation (including the accounting one).

The process of change was not a continuous one; hence, while literature identifies several stages of accounting reform, they differ from author to author in respect with the number of these phases, the beginning and ending years, and their duration. These differences are explained by the fact that some authors focus their analysis on the process of elaboration of accounting regulations, since others focus on the effects of the regulations. For example, Ionaşcu et al. (2007) distinguish three stages, while Matiş and Pop (2007 cited in Mustaţă, 2008) and Calu (2005) consider 5 periods in the evolution of the Romanian accounting system.

For the purpose of our paper, we are interested in analyzing the consequences of the application of accounting regulations, hence we will distinguish between periods based on the issuance (and application) of accounting regulations, as follows:

1. 1990 to 1993 – The Accounting Law was passed in 1991 and the Government Decision no. 704 were issued in 1993 to implement the Accounting Law. Calu (2005) considers that this was a transition period from the Soviet model towards a French inspiration model. The new accounting regulations are applied starting 1994.
2. 1994 to 1999 (for large companies) and 1994 to 2002 (for SMEs) – represents the period of application of the accounting system of French inspiration. The regulators insisted on the fact that the system was based on the 4th European Directive, and French experts merely assisted in the elaboration of the regulation; thus it was not about "importing" the French accounting system entirely. However, many accounting policies existing in France at that time were used in the Romanian model, and all authors agreed that this period was accordingly, one of French influence. Describing that period, Roberts (2000) noted that: "Romania would adopt a continental type of accounting with specific inspiration drawn from the French example." During the period of application, the second reform of the accounting system was initiated, following the imposition of the World Bank and other international organizations. The opponents of these influences will later characterize the process as one of "cultural intrusion" (Delesalle and Delesalle, 2000; Roberts, 2000), while others considered that this was a choice for ensuring harmonization (Calu, 2005; Mustaţă, 2008).
3. 2000 to 2005 (for large companies) – in 1999 the Order of the Minister of Finances no. 403 was issued, and was replaced in 2001 by the Order no. 94. They both aimed at the harmonization of the accounting system of large companies with ED and with IASs. Many provisions from IASs were consequently included in the national regulations and IASs were even incorporated in them. Based on size criteria, more and more large companies were supposed to adopt these regulations. Several studies discuss how IASs were applied during this period and the potential costs and effects of such an application (Ionaşcu et al., 2007; Albu et al., 2010).
4. 2003 to 2005 (for SMEs) – the Order no. 306 was issued in 2002, aimed at harmonizing the accounting

system for SMEs with the European Directives. Also, this Order was intended to reduce the differences between the accounting system for large companies and the one for SMEs, thus many definitions and policies included also had IASs at their origin.

5. 2006 to 2009 – considering the intended Romanian adhesion to the European Union, the Order no. 1752 was issued in 2005, and was applied starting 2006. It intended the harmonization with the European Directives, but for the continuity many provisions from IASs/IFRSs were kept (if they were not conflicting with the ED, as the representatives of the Romanian regulator explain in Albu et al., 2010).

6. 2010 to nowadays – at the end of 2009 the Order no. 3055 was issued to replace the Order no. 1752. It continues the same directions, meaning the application of ED with many provisions from IFRSs.

Table 1 recapitulates the evolution of Romanian regulations applicable for SMEs, as well as the major points characterizing them.

Romanian fiscal regulations

Our review is focused on changes in profit tax regulations in Romania since the accounting-taxation relationship is analyzed from the profit (income) tax point of view. 1991 is the starting point in the emergence of profit tax in the national economy, by redefining property rights, emergence of private and mixed companies and conversion of public into private property. As a consequence, these changes created the legal framework to regulate economic activities on the basis of free enterprise in industry, trade and service sectors, under Decree-Law no. 54/5.02.1990 regarding the organization of economic activities based on free enterprise. Initially, in accordance with this decree, taxation of for-profit-entities' profits was made by applying progressive rates ranging between 10 and 50%, the tax cuts except that portion of up to 50,000 lei was exempted, and the first year of operation is 30% discounted from the tax due.

With the advent of Law no. 15 / 7.08.1990, the public economic companies were reorganized into autonomous and private economic companies and the emergence of the Companies Act (Law no. 31 / 11.16.1990), company sampling and net production value of the benefits were replaced by the introduction of profit tax in 1991. From its creation onwards the profit tax has gone through multiple adjustments, which made its imposition to be characterized by instability. Table 2 presents the main changes in profit tax regulations from 1991 to 2010.

HYPOTHESIS AND MODEL DEVELOPMENT

Our aim is to determine the influence of taxation over accounting (data). For this purpose we needed: (1) to clarify the conceptual relationship between taxation and accounting, and (2) to find the appropriate measurement tool.

The conceptual relationship between accounting and taxation was discussed in the literature review section. Although we found several approaches, we build our investigation on Lamb et al. (1998) and Nobes and Schwencke (2006), since this model seems to be the most complete. According to these authors there are several levels (referred to as 'stages') of accounting-taxation interaction. We simplify their approach as follows: disconnection, accounting dominates (connection I) and taxation dominates (connection II). (see Figure 1) Based on this, our hypothesis can be stated as follows:

H_0: Accounting *is not* connected with taxation (disconnection).
H_A: Accounting *is* connected with taxation (connection I or II).

Further, if we can prove accounting is connected with taxation (equivalent to rejecting H_0), the next question is which one influences the other: does accounting impact taxation or is it the other way around? We use findings by other authors (Bosnyák, 2003; Krzywda and Schroeder, 2007; Fekete et al., 2010) according to which accounttants take in consideration fiscal issues when making accounting (policy) choices and not vice versa (). Our hypothesis can be restated as follows:

H_0: Accounting is *not* connected with taxation (disconnection)
H_{a1}: Accounting *dominates* taxation (connection I)
H_{a2}: Taxation *dominates* accounting (connection II).

Consequently, if the null-hypothesis is rejected we accept H_{a2}, that is, accounting is influenced by taxation not the other way around (H_{a1} being excluded for economic reasons, on the basis of previous literature and empirical findings).

We test this construct by a linear econometric model. In order to build the model, we must find the appropriate measurement tool to capture the level of such connection. Previous literature (Gallego, 2004) and also normative texts consider *accounting income* as a proxy for accounting effects, and *taxable income* (income tax basis) as the most appropriate proxy for fiscal effects. Gallego (2004) argues that "the calculation of two different figures following different methodologies gives rise to the existence of important differences between both types of income". In such a case accounting is considered as being disconnected from taxation.

However, running a regression between accounting profit and fiscal profit would be inappropriate at least for two reasons, as explained in Fekete et al. (2009). First, accounting profit contains many discretionary

Table 1. Evolution of Romanian accounting regulations for SMEs.

Stage	Accounting regulation	Effective date	Major issues
1990 - 1993	Accounting Law No. 82/24.12.1991	January 1, 1992	The general framework of the organization of accounting The financial statements ('balance sheet' in original) shall give a true and a fair view of a company's patrimony (ro. *patrimoniu*) and results
1994 - 2002	Government decision No. 704/14.12.1993	January 1, 1994	Chart of accounts Detailed rules of valuation Accounting principles are introduced Horizontal layout of the balance sheet
2003 - 2005	Order of the Minister of Public Finances No. 306/25.04.2002	January 1, 2003	Vertical layout of the balance sheet Eliminations of the concept of 'patrimony' Materiality and substance over form are not included Definitions of financial statements items inspired by IFRSs Some policies of IFRSs inspiration
2006 - 2009	Order of the Minister of Public Finances No. 1752/17.11.2005	January 1, 2006	Simplified financial statements for those companies under a certain limit[2] (only balance sheet, income statements and notes) Materiality and substance over form are not included Definitions and policies from IFRSs
2010 – present	Order of the Minister of Public Finances No. 3055/29.10.2009	January 1, 2010	Similar provisions as in OMFP 1752 Users of financial statements and qualitative characteristics of the accounting information are acknowledged (from the IASC conceptual framework) Materiality and substance over form principles are included

adjustments for fiscal purposes, such as amortization/ depreciation, impairment, provisions etc. Second, fiscal profit is not disclosed by companies and would not be applicable if there were multiple tax rates. For this reason, following Fekete et al. (2009), we propose the subsequent proxies:

(a) *Sales*, to capture accounting data; this figure contains the least fiscal effects (adjustments); and
(b) *Profit tax*, to capture fiscal data; this remains a correct proxy even if the taxable income definition or tax rate change over time.

The simplest model that captures the relationship between accounting and taxation can be stated as:

Sales = f (Profit tax)

This model, however, is strongly biased by scale effect. Jones (1991) introduces a control for size effect deflating

Table 2. Evolution of profit tax regulations in Romania.

Stage	Tax regulation	Effective date	Main changes introduced
1991 – 1992	Law No. 12/30.01.1991 on the profit tax	January 1, 1991	Progressive tax was applied, with a total of 67 tax cuts Tax cuts were between 2.5% and 77%, with a profit of 25,000 lei, relieved from duty Taxable profit was calculated as the difference between revenue received and expenditure provided by law
1992 – 1994	Government Decision No. 804/30.11.1991 on the profit tax	January 1, 1992	Progressive rates were reduced to two rates, as follows: 30% for a taxable profit under 1 million lei 45% for a taxable profit over 1 million lei
1995 – 1996	Government Ordinance No. 70/29.08.1994 on the profit tax	January 1, 1995	Profit tax rate was set at 38% Differential tax rates were applied for certain categories of taxable persons A distinction between small and large taxpayers is made; the tax base was established depending on the category of taxpayer, as follows: - for large taxpayers, taxable income = (assets at the end of year [(1)] - obligations) - (assets in early [(1)] - obligations) - the capital contribution made during the year - tax-free revenue + non-deductible expenses - for small taxpayers, taxable profit = total revenue - total expenses – tax-free revenue + non-deductible expenses Concepts of tax-free income and non-deductible expenses are introduced; unclear setting conditions were established for tax-free revenue For certain expenses partial deduction was applied (e.g. for gifts and subsidies granted were established tax-deductible limit set by law)
1997 – 1999	Government Ordinance No. 70/29.08.1994 on the profit tax, republished, approved by Law No.73/ 12.07.1996	January 1, 1997	Elimination of the distinction between small and large taxpayers Taxable profit = total revenue - total expenses + non-deductible expenses Elimination of the distinction between accounting depreciation and tax depreciation
2000 - 2004	Government Emergency Ordinance No. 217/29.12.1999 for amending and supplementing the Government Ordinance No. 70 / 1994, approved by Law No. 189 / 17.04.	January 1, 2000	Profit tax rate was set at 25% Explanations were provided for the total deduction (e.g. operating lease rent, depreciation and interest that financial leasing) or partial deduction (e.g. entertainment expenses in the limit of 2% laid down in the tax base) of expenditure included in the calculation of taxable income.

Table 2. Contd.

			The concept of taxable income is reintroduced; it may occur for property revaluation
	Law No. 414 / 26.06.2002 on the profit tax, 1994 (2)	July 1, 2002	Taxable profit = total revenue - total expenses – tax-free revenue + non-deductible expenses
			The categories of free-tax revenue were defined
	Law No. 571 / 22.12.2003 on the Fiscal Code (3)	January 1, 2004	Taxes and fees due to the state budget and local budgets are regulated, income taxes being regulated under Chapter II of this Law
			The categories of free-tax revenue, deductible expenses, partially deductible expenses, and fully non-deductible expenses are distinctly regulated
			Distinction between accounting depreciation and tax depreciation
			The amount of reserves that can be deducted in the determination of taxable income and tax deductible provisions is distinctly regulated
			The determination of the deductibility of interest expenses and the foreign exchange loses is distinctly regulated
			Tax credit concept is introduced; the most common tax credit is represented by the deduction of the gifts and subsidies expense from profit tax, granted in the amount according to law
2005 – Present	Government Emergency Ordinance No. 138 /29.12.2004 for amending and supplementing the Law No. 571 / 2003 on the Fiscal Code, approved by the Law No. 163 / 01.06.2005	January 1, 2005	Profit tax rate was set at 16%
	Government Emergency Ordinance No. 34 / 11.04.2009 on the 2009 budget rectification and regulation of financial and fiscal measures, approved by the Law No. 227 / 10.06.2009	May 1, 2009	Introduction of the minimum tax which is applied on companies revenues obtained in the previous year, whether or not they obtain profit
			The deductibility of expenses for certain sectors, such as fuel expenditure, value added tax related to the purchase of cars, was eliminated The tax measures apply until 31.12.2010
	Government Emergency Ordinance No. 87 /29.09.2010 for amending and supplementing the Law No. 571 / 2003 on the Fiscal Code	October 1, 2010	The minimum tax imposed by Government Emergency Ordinance No. 34 / 2009 is eliminated

(1)The asset of the end and beginning of the period was updated for inflation.
(2)Law No. 414 / 2002 was amended by Government Ordinance No. 36 /30.01.2003 on the correlation of financial and tax provisions, published in the Romanian Official Journal No. 68 / 02.02.2003, approved by Law No. 232 /31.05.2003, published in the Romanian Official Journal No. 373 /31.05.2003. According to this Government Ordinance clarifications on the method of determination the taxable profit were brought. (3)Law No. 571/2003 on the Fiscal Code was amended from the beginning until now by 74 regulations, entering usually into force form January 1 of the next year of its publication in the Romanian Official Journal.

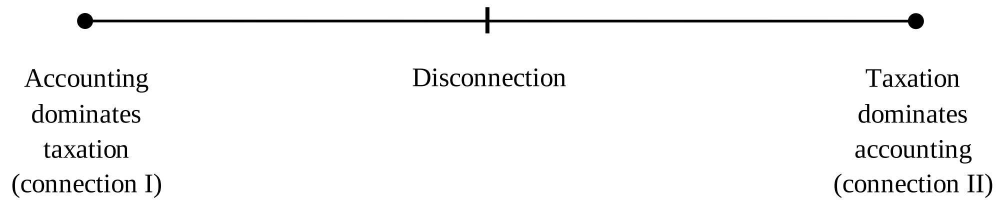


Figure 1. Conceptual relationship between accounting and taxation.

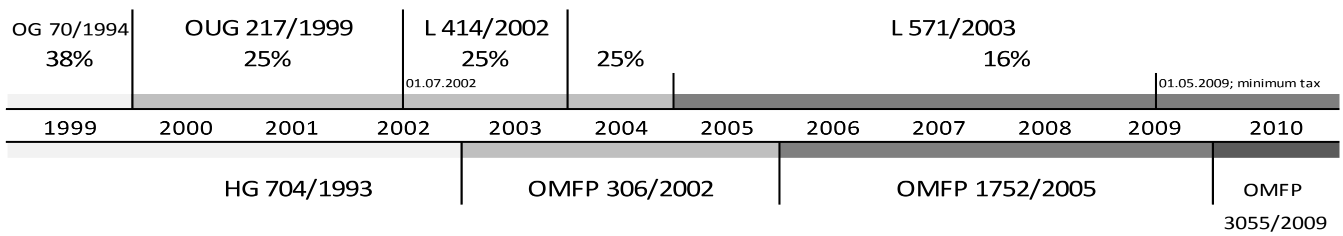


Figure 2. Comparative evolution of accounting and taxation regulations between 1999 and 2010. Percentages are profit tax rates applicable for the period.

all variables by total asset value at the beginning of the year. We change this approach to year-ending values, because accounting rules change several times during the period analyzed and we avoid mixing up data obtained under different versions of accounting regulation. Therefore our final proposal for the econometric model is:

Sales / Total assets = f (Profit tax / Total assets)

or, in a more analytical form:

$$\frac{Sales_{t,j}}{A_{t,j}} = \alpha_0 + \alpha_1 \frac{Tax_{t,j}}{A_{t,j}} + \varepsilon \qquad (3)$$

where:
$Sales_{t,j}$ = sales of firm *j* in year *t* in Romanian Lei – RON[3];
$Tax_{t,j}$ = profit tax of firm *j* in year *t* in RON;
$A_{t,j}$ = total assets of firm *j* in year *t* in RON.

The period under observation, sample of firms and data collection are explained in detail subsequently.

DATA MANAGEMENT

We use Romanian data to test the proposed model. The period under observation is 11 years, from 1999 to 2009, and it can be characterized as the period of intense changes in both accounting and fiscal regulations, as described earlier. We consider this is a great opportunity to study the relationship between accounting and taxation, because during this period several changes have affected both accounting and fiscal regulations, potentially impacting taxation-accounting relationship, as presented in Figure 2.

Since the model is cross-sectional, in order to ensure the comparability of results we intended to use a paired-sample approach for the entire period. Unfortunately data management considerations made impossible such an approach. For this reason we turned to a modified paired-sample approach, according to which we used a common basic sample of firms (336 entities) from which we eliminated unsuited observations during the 11 years period, for analysis (negative results) or data management (missing or incorrect data) reasons. Hence, the maximum number of companies used is 176 (in 2003), while the minimum is 117 (in 2009). Table 3 explains the sample definition.

Access was granted to a database created for a previous research grant by a team led by Prof. Matiş of Babeş-Bolyai University of Cluj-Napoca, Romania, for the period between 1999 and 2003; these data were supplemented for 2004 to 2009 with hand collected data from the official website of the Romanian Ministry of Public Finances (www.mfinante.ro). The source of data is the individual annual financial statement of SMEs (amounts expressed in RON), prepared under Romanian accounting regulations in use on the respective balance sheet date.

RESULTS AND DISCUSSION

After running a regression (Equation 3) for each of the year under observation, we obtained the results summarized in Table 4. The influence of taxation over accounting is captured by R^2_{adj}, which shows a high level of variability, from 99.8% in 1999 to the lowest level of 2.6% in 2004, and back again to 99.6% in 2009; Figure 3 presents the evolution of the R-square indicator.

From a statistical point of view both the model (F-test) and the factor (t-test) are significant on acceptable levels

Table 3. Sample definition.

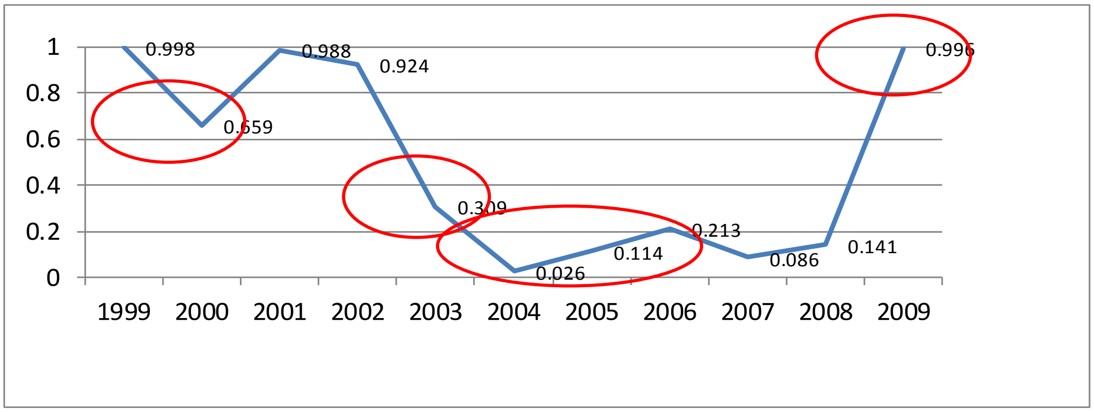
Explanations										No. of entities
Romanian SMEs included originally considered										336
Less:										
- companies with negative results in any of 1999 - 2009										112
- companies excluded for data management reasons (varying across the years)										From 48 to 107
Companies included in the sample (varying across the years)										From 117 to 176
1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
130	149	163	174	176	138	140	136	127	124	117

Table 4. OLS regression model (3) for the years analyzed.

Year	Variable	α	t	F	R^2_{adj}	N
1999	Constant Tax/A	1.912 11.841	8.488*** 265.11***	70,283.54***	0.998	130
2000	Constant Tax/A	2.298 3.728	11.900*** 16.944***	287.091***	0.659	149
2001	Constant Tax/A	1.313 44.962	2.282** 114.081***	13,014.46***	0.988	163
2002	Constant Tax/A	-0.221 72.430	-0.433 45.946***	2,111.00***	0.924	174
2003	Constant Tax/A	1.545 41.781	3.750*** 8.913***	79.439***	0.309	176
2004	Constant Tax/A	1.899 9.447	11.246*** 2.146*	4.606*	0.026	138
2005	Constant Tax/A	1.492 21.317	10.515*** 4.348***	18.904***	0.114	140
2006	Constant Tax/A	1.452 10.092	10.878*** 6.131***	37.594***	0.213	136
2007	Constant Tax/A	1.298 14.961	11.328*** 3.581***	12.824***	0.086	127
2008	Constant Tax/A	1.179 27.460	8.599*** 4.601***	21.166***	0.141	124
2009	Constant Tax/A	0.802 33.214	6.129*** 165.56***	27,411.41***	0.996	117

*, ** and *** denote significance at the 0.05, 0.01 and 0.001 level, respectively.

(0.05 or even 0.001 level); therefore we reject the null-hypothesis of disconnection and accept H_{A2}, according to which taxation significantly influences accounting of SMEs (displaying a type II connection).



Changes in regulations:

Acc					1			1			
Tax		1			1	1	1				1

Figure 3. Evolution of R^2_{adj} between 1999 and 2009.

A further question is how we can interpret these dramatic variations of the taxation-accounting relationship. One factor that could explain the disconnection of accounting from taxation is the *change in the behavior (accounting practice) of companies*. This means that it is less and less probable that accountants apply fiscal rules/options in their accounting (policy) choices. However, researching these changes in behavior would require data collection by questionnaire for each year, which it is not possible (as the years have passed). On the other hand our aim in this paper is to quantify the impact of taxation on SME accounting; identifying and measuring the company specific (microeconomic) factors that lead to this impact could be the objective of a future study.

In 2000 changes in the fiscal regulations (and possibly other factors) resulted in a 33.9% drop of the impact of taxation on accounting (from 99.8 to 65.9%). In 2001 to 2002 no changes occurred in the legislation; therefore the movements in the R-square are due to company specific factors. Between 2003 and 2006 both accounting and taxation regulations suffered significant modifications. In 2003 both accounting and fiscal regulations were changed; this triggered a significant drop in the R-square indicator from 92.4 to 30.9%. After that, further amendments in 2004, 2005 and 2006 changed the impact of taxation over accounting both downwards (the lowest level being in 2004 with 2.6%) and upwards (to 21.3% in 2006). In 2007 to 2008 no significant changes occurred in the legislation; movements in R-square are again primarily due to company specific factors. In 2009 the minimum tax was introduced, which led to a high tax impact on SME accounting (R-square rise up again to 99.6%).

Another factor that could explain the impact of taxation on SME accounting is *changes in legislations*. Since this is a country specific (macroeconomic) factor, we can use it in our investigation.

For this purpose we continue the analysis by taking into consideration the changes that occurred in both accounting and fiscal regulations. We assign 1 to each year when the legislation changed (the first year of the application of the new regulation), and 0 to the rest of the years, separately for accounting and taxation regulations. For example, the year 2000 receives 1 from a fiscal point of view, when the provision of the Ordinance no.217/1999 started to be applied, as it produced significant changes in profit taxes (changing the rate to 25% and the tax base). The same year receives 0 from the accounting point of view, since there were no changes in the accounting regulations.

After obtaining the two sets of dummy variables, we investigate where the level of taxation-accounting relationship is associated with changes in regulations, more precisely, if changes in accounting or fiscal regulations affect the impact of taxation on accounting. We measure this by computing correlation coefficients. Table 5 summarizes the results.

In both cases the value of the correlation coefficient is low and negative. This means that changes in both accounting and fiscal regulations lead to smaller level of taxation-accounting relationship (to disconnection), but the strength of this phenomenon is rather low ($\rho < 0.30$).

CONCLUSIONS AND SUGGESTIONS

In this paper we performed an empirical analysis on a period of 11 years seeking to bring evidence on the relationship between accounting and taxation in the context of Romanian SMEs. We applied an econometric

Table 5. Changes in regulations and their economic consequences.

Panel A. Changes in accounting regulations										
1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
0	0	0	0	1	0	0	1	0	0	0
ρ = -0.11										
Panel B. Changes in fiscal regulations										
1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
0	1	0	0	1	1	1	0	0	0	1
ρ = -0.29										

model proposed by Fekete et al. (2009) to capture the *de facto* fiscal influence on accounting.

Our results confirm that: (1) SME accounting is strongly and significantly influenced by taxation (the R-square levels are rather high and the models are statistically significant); (2) the level of fiscal influence over accounting varies over time (from 99.8% in 1999 to the lowest level of 2.6% in 2004 and back again to 99.6% in 2009); and (3) the level of fiscal influence seems to be connected with changes in accounting and/or fiscal regulations in the sense that changes in both accounting and fiscal regulations lead to smaller level of taxation impact on accounting (to disconnection), but the strength of this phenomenon is rather low. Future research might investigate the nature of the changes in both accounting and taxation regulations, and their degree of influence on the relationship between accounting and taxation. For example, the extent to which what we consider to be the most drastic change of accounting regulations (after 2003) impacted this relationship as reflected by our results for 2003 to 2007.

In analyzing these results the evolution of the economic environment must also be investigated. The economic crisis apparently led to a focus on the tax conformity, because the departure from taxation increases the costs (Blake et al., 1998). A previous study (Chan et al., 2010) conducted in an emerging economy documented that the decrease in book-tax conformity leads to an increase in tax non-compliance.

Future research may analyze the extent to which the period 2003 to 2007 was associated with tax non-compliance. Also, the effects associated to the recent increase in book-tax conformity could be investigated, since literature provides different interpretations, some arguing that it leads to a reduction in earnings management and others supporting the idea of less informative accounting information (Hanlon et al., 2008).

In carrying out the research we were strongly limited by empirical data issues. Since there is no public database in Romania, obtaining data on SME level is very costly, which is a significant obstacle in doing such research. Another limitation pertains to the model applied, that is, the proxies used. However, identifying new approaches are excellent opportunities for future research.

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*** www.mfinante.ro

Notes

[1] In the Anglo-Saxon literature the concept of *tax accounting* is used to clearly distinguish it from *financial accounting* (reporting). The objective of tax accounting is to provide financial information for the State (for example, calculation of income tax base), while financial reporting provides information to the users of financial statements (shareholders, creditors etc.).

[2] Entities which do not comply with 2 of the 3 size criteria specified in the Order (Total assets exceeding 3.65 million euros, weighted number of employees exceeding 50, and sales exceeding 7.3 million euros).

[3] Note that on the 1st of July 2005, the national currency (former Romanian Leu, ROL), has been redenominated so that 10,000 old lei were exchanged for 1 New Leu (RON).