

ASPECTS REGARDING THE REGULATORY RISKS RELATED TO SHAREHOLDER'S EQUITY

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Abstract: : These instructions The set of regulations regarding the shareholders' equity may also include aspects which, by an inadequate interpretation, represent risk factors. Thus, the research performed within this material identifies the main regulatory risks of this kind, specific to subsequent establishment and operation of trading companies, as well as those in connection with their amalgamation, dissolution and liquidation operations.

JEL classification: M40, M41.

Key words: shareholders' equity, initial regulatory risks, ulterior regulatory risks, accounting information.

1. INTRODUCTION

Trading companies organization and operation, as is widely recognized, are strictly regulated, being released all essential elements generated by their life and particularly those with implications on shareholders' equity.

Therewith, it seems appropriate to mention that this type of regulations may also contain provisions that are less clear or interpretable which, allowing controversial solutions, represent the source of some potential risks. In other words, with reference only to the shareholders' equity of trading companies, it may encounter situations where some operations or transformations that occur in their volume and structure aren't legally covered, in detail, fact that may be named as a regulatory failure. In this regard, we consider the large number of amendments and additions to the content of regulations which we refer to, the relatively large casuistry registered to judiciary bodies and the diversity of solutions adopted by the Ministry of Public Finance, in relation to accounting management on shareholders' equity, thus aiming to eliminate some initial regulation shortcomings and, respectively, to improve the quality of accounting information corresponding to the patrimony of trading companies, etc.

2. OBJECTIVES

The research performed allowed us to identify the regulatory risk regarding the shareholders' equity both on the trading companies foundation, as a consequence of economic and legal regime of contributions, and also during their functioning, as a consequence of special circumstances that modify their volume and structure.

Also, we note that regulatory risk can be identified also in case of amalgamation, dissolution and liquidation of trading companies, events over which it exercises, decisively, the influence of several factors regarding the economic environment, the policies adopted in the field and the market conditions where organizations operate.

In connection with this last aspect, we remember, in a first step, the most important economic factors that influenced, with different intensities, reorganization decisions of the company, namely: inflation rate, interest rate, exchange rate of national currency and the unemployment rate, and also taxation, economic cycles, state of national financial market, development degree of banking system, security and facilities regarding the access and the transfer of financial capital, investments regime, economic, custom and fiscal levers of the state, development, regulatory, competitive and liberalization degree of the market.

We also consider that it is relevant to emphasize the fiscal policy, because its role regarding the dynamics of economic entities' activity is obvious. This factor is manifested, primarily, by eliminating or by introducing facilities such as reductions of custom and excise duties, elimination of subsidies, tax exemption for reinvested profit etc., which influences favorably or unfavorably, as appropriate, and shareholders' equity of the company. However, for the current period, in our country must be emphasized the fact that, although there is a low level of taxation, as weight of budgetary revenues in GDP, this is cumbersome on the entity's level. Although income tax diminished from 38% to 25% and thereafter to 16%, however it is above European average, being relatively high in terms of acute need of funding sources for trading companies.

Among political factors with implications on operations mentioned, it stands out in relief the quality of national long term development strategies, the stability and the coherence of general legal framework and, in particular, of economic legislation (economic policies and regulations, fiscal and customs, incentive policy to certain industries and investments) etc.

Considering the social and economic context presented, we may note that regulatory risk has consequences and impact on the foundation, functioning and transformation of trading companies, but especially regarding the amendment decision of shareholders' equity, decision that concludes by amending the constitutive act. Extraordinary general meeting is the competent body which decides the caring out of any amendment of this document of trading company. In this case, on one hand, are naturally analyzed economic circumstances which may influence the evolution of company's life and, on the other hand, based on information available on production of certain events, it is determined the optimal moment to achieve the operation expected, and also the size and the use way related to shareholders' equity.

Event more relevant or, in other words, situations that, in the spirit of regulations from our country, directly influence the shareholders' equity, in the

sense of amendments of their volume and/or structure, and also accounting information through which these are known by those interested, are determined by:

- exclusion of some partners from the company or its merger, fact that will reduce and, respectively, will increase or decrease, as appropriate, the social capital;
- partial assignment of social parties or of contribution to social capital by third parties, cleavage, establishment of subsidiaries or branches etc., events that represent the attribute of capital' holder;
- transmission of social capital contribution to the heirs and the business continuation under new association conditions;
- change of organization form of the company, such as its transformation in a limited liability company in a company stock;
- issuing new shares and ensuring financial protection of old shareholders, when necessary.

3. METHODOLOGY

Documentary sources consulted provided sufficient information to support our opinion according to which the insufficiency of organization and functioning regulations of economic entities has a consequence on accounting information credibility and reality on their shareholders' equity, and the cause associated to the consequence is represented by the high degree of interpretability of legal rules in relation to some aspects and events registered during the formation and, particularly, during the functioning of the entity. In terms of management, we consider that this fact identifies with regulatory risk.

4. ANALYSES

4.1 Regulatory risk regarding the shareholders' equity on the foundation of trading companies

In the same vein, we consider that the amendments brought to regulations in the field have significant influence on shareholders' equity, with consequences on the companies functioning and/or on the fulfillment of some conditions imposed by laws, fact that also influences the related accounting information. The aspects of this kind may have benefic effect when, through others, they have a deterrent role regarding the manifestation of bankruptcy or abolishment risk as a consequence of non-fulfillment of some minimum legal conditions. In this sense, we exemplify the assessment of minimum limit of social capital for holding companies from 2.500 lei to 25.000 Euros, so an accrual of approximately 35 times and this in a relatively short period of time (imposed by regulation up to 27.10.2006). In order to fulfill this condition, we consider that, besides the fact that the management was placed in the position to found adequate solutions for the putting-up of social capital, it was also necessary and legal the shareholders' information thus this be in the know for adopting such a decision or for establishing another way to ensure the conservation of initial investment benefits.

At present, the regulation mentioned sets the minimum social capital limit for holding companies to 90.000 lei, with determination that this minimum value may be modified at most one time to two years, thus it represent the lei equivalent of the amount of 25.000 Euros.

In the same vein, depending on information obtained during the documentation made, we highlight the fact that amendments risks of initial regulations regarding the shareholders' equity of organization are relatively frequent and they affect significantly the quantity and the diversity of accounting information that it reflects, in the sense that it must obtained in this way, so, on one hand, it contributes to the grounding of decisions adopted by A.G.A. for solving the situation generated by the risk appeared and, on the other hand, it reflects with promptitude and credibility the amendments operated to searchable capitals.

For adequate management of risks mentioned, are very important the experience, the professionalism and the preoccupation of organization's management which, in their establishment period, allow them to manifest prevision or prudence sense, considering possible subsequent regulation risks. In the same time, we consider that, in order to achieve this desideratum, we don't have to ignore accounting information on shareholders' equity that, carefully analyzed and interpreted, may contribute, through other things, to adoption of the decision to distribute amounts from profit for constituting some reasonable financial reserves intended, when necessary, to the use for solving some issues as those mentioned.

4.2 Regulatory risk regarding shareholders' equity during the functioning of trading companies

In other words, but also with reference to shareholders' equity of trading companies, and also to related accounting information, we consider **the interpretation risk of regulations regarding the putting-up of social capital.**

Legal regime corresponding to the functioning of trading companies allows us to find that the putting-up of social capital represents a mechanism with various solving methods, used by the entity in the scope of solving some difficult financial situation or of consolidating its position, for reflecting objective financial phenomena, as monetary depreciation.

In our countries, the regulations into force anticipate that the putting-up of social capital may occur, firstly, by subscription of new contributions in cash and/or in nature. In the same time, are allowed, with the same scope, modalities regarding the incorporation, in the social capital, of statutory reserve, of benefits related to capital and those realized by the company, not being allowed the legal reserves and the reserves from reevaluation.

Although law text is very clear, and most of the experts in the field consider that legal reserves can not represent a putting-up source of social capital¹, however it appeared the opinion according to which any accounting reserve is embeddable in social capital, with the condition that it should have been constituted in the conditions of law and of constitutive act and, in the same time, to be real, meaning to have a counterpart in the asset.

¹ Cărpenaru S., Romanian Commercial Law, All-Beck Publishing House, Bucharest, 1998.

In the sense of this last opinion, even the Tax Code (The Law no. 571/2003, art. 22 – 1.a) may be invoked. This code contains the provision according to which, when legal reserve is distributed in any form, its subsequent reconstruction is not deductible anymore in calculating taxable profit. Thus, we may interpret that legal reserves may be used for the accrual of social capital, but without ignoring that there is subsequent obligation according to which the amounts thus used are reconstituted only from taxable profit, as for the other types of reserves.

Considering the risk appeared as a consequence of law interpretation, we hesitate about legal reserves and we consider that their incorporation in social capital must be favorably regarded only because the simple fact that it represents the bailment of social creditors.

From the research carried out it resulted that the reserves incorporation in social capital concludes, based on a preparatory decision of general meeting of shareholders or of partners, in an internal operation, meaning that the reserves are transferred to social capital account. So, in an accounting way, it concretizes by transferring the respective amount from an account to another, but only if legal requirements are met.

4.3 Regulatory risk regarding the amalgamation decision

This is caused by some interpretations that may legally have consequences on economy. Considering the types of amalgamation (absorption and association) and the effects of each of them, we may interpret that, once with the patrimonies' unification; also an association of law subjects is produced. Furthermore, this represents an essential element for any operation of this kind. In support of this view, experts in the field of commercial law² also invoke the fact that: *“incorporation, by a trading company, of the branches of such a company, represents a concession of goodwill and not a merger, because, after this operation (which concerns only a part of the patrimony of releaser company), the company who ceases will continue to keep the quality of legal person, different from the transferee company”*.

According to another opinion, the merger or the dissolution of trading companies represents, not their transformation, but an anticipated dissolution, which implies an amendment of articles of incorporation of another company, meaning that social capital will be increased with that corresponding to dissolved company and even the birth of another company, based on different articles of incorporation, by associating the patrimonies of companies thus dissolved³.

In our opinion, based on economic experience and implicitly, on available information, although we can not contest the fact that the merger attracts the dissolution of absorbed or associated company, the operation through which an entity thus loses its status of legal person is determined by the continuity idea by patrimony's transmission and not by its disappearance. Anticipated dissolution for merger place the partners of absorbed or associated entity in the situation of becoming partners of the beneficiary

² Costin M., Jeflea C.A., Unlimited Companies, Lumina Lex Publishing House, Bucharest, 1999.

³ Carcei E. ,Romanian Commercial Law, All-Beck Publishing House, Bucharest, 2000.

company, in the conditions convened by parties. The relationships between the partners of involved economic entities are delimited depending on change report of social shares or quotes.

For possible investors after this merger, the effects of this operation, presented, succinctly, hereinafter, are very interesting:

- Creditors of absorbed company become creditors of absorbing entity or, in other words, the creditors of disappeared company become creditors of the company resulting from the merger.

- Absorbing company becomes, implicitly, the creditor of the debtors of absorbed company, respectively the resulting company becomes creditor for the debtors of disappeared company.

- Amended articles of incorporation refer, for the merger through absorption, only the absorbing entity.

In connection with the inhibition and the mitigation of regulatory risk regarding the merger, we think that the carefully setting of merger's terms is important, so as to not allow subjective interpretations and, implicitly, subsequent economic consequences, particularly for absorbed company, since its articles of incorporation are not anymore, legally, valid, abolishing once with the entity.

With reference to the articles of incorporation of absorbed company, it is mentioned that this may be modified with regards to social capital that increases, and also with regards to the object of activity, the absorbing company being allowed to take, in order to complete its initial activities and certain elements from the component of the object of activity of absorbed company. Thus, for such an operation, it is applied only an amendment procedure of articles of incorporation, respectively that corresponding to the merger. In this sense, we mention only the fact that the accrual of social capital of absorbing company is an inherent consequence of merger through absorption. The procedure specific to increasing operation of social capital is neutralized (by its absorption) by the merger procedure. As a consequence, the putting-up of the capital thus achieved is considered to be validly made even if some regulatory details concerning the putting-up of social capital, in general, do not appear in absorption merger procedure.

4.4 Regulatory risks for trading companies' separation

As known, the separation is the operation by means of which a company transfers its whole patrimony to two or more existing entities or with which it founds, by transferring actions or social quotes to the partners of the company which separates. Thus, for such an operation, there is a company which separates, named transmissible, and one or more beneficiary companies that absorb its patrimony, fully or in part, as appropriate. If the separation method by absorption is adopted, the transmissible trading company transfers the patrimony, universally, to two or more existing beneficiary companies, ensuring the allocation of shares or social quotes to entitled partners.

Actually, we note that, from casuistic registered in terms of separation and according to the opinion of some experts in the field, such operation represents an association of patrimonial elements, including shareholders' equity, with normal implications on accounting information.

In the same time, we should mention that, according to Romanian legislation, “separation is made by dividing the entire patrimony of a company that is divided into two or more existing companies or thus appearing”. In the sense of this definition for separation operation, we may highlight that regulatory risk “lives” base on the fact that it takes in consideration only the hypothesis of total separation, fact that doesn’t imply the amendment of articles of incorporation of the entity that is separated.

In our vision, the issue analyzed must be regarded from another point of view that considers the results or the finality corresponding to legal methods of achieving this operation, respectively absorption and association. In order to sustain this point of view, we invoke the economic practice in the field, meaning that the first hypothesis is necessary for the amendment of articles of incorporation of companies between which is shared the patrimony of separated company, because it concerns the accrual of social capital with the part from the patrimony that is incorporated in the patrimony of beneficiary entity. For the second hypothesis, when by means of separation new trading companies are formed, is not necessary the amendment of articles of incorporation, preparing articles of incorporation corresponding to each entity founded.

In the same vain, we consider that regulatory risk regarding the shareholders’ equity is more accentuated if the object of the separation is represented only by a part of the patrimony of an entity, operation that we consider to be a partial separation. In this case, the shareholders’ equity of all entities involved in each time of operation, including their articles of incorporation and the related accounting information, are affected. Also, the accountancy ensures, in a first step, the necessary data for establishing the shares transferred, and then it highlights, with details, economic operations carried out, on the level of each involved entity, reflecting, subsequently, the volume and the structure of the portfolio of shares or social quotes owned by them.

Regulatory risk that we consider obvious for such operations implies that, by reporting a part from the patrimony’s asset in exchange for shares or social quotes attributed to the partners of entity devised by beneficiary entities, the real value of these securities, fact that represents an important issue that isn’t solved by regulatory text. Thus, the decision that has to be adopted is of entities involved in partial separation operation and can unfavorably influenced, for one of participating parties, through subjective interpretations. In order to avoid such a situation, we consider usefully that each of interesting entity should use, with professionalism, the accounting information and also other available information, supplied by third parties, determining valued related to shares or to respective social quotes, as close to real ones, that contribute to financial protection of all those owning such securities to those entities.

5. CONCLUSIONS

Regulations that aim shareholders’ equity of the entity represents a significant influencing factor of their volume and structure, and also of accounting information by means of which they are known to those interested.

In this respect, in summary, we can argue that the regulations submitted for discussion within the research carried out, can generate a set of risks that, correlated

with relevant events, from the entity, regarding the shareholders' equity, should be considered in the proper management of this significant component of resources at her disposal.

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