FINANCIAL TOOLS AND RISKS RELATED TO THEIR USE BY ECONOMIC ENTITIES IN ROMANIA

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ABSTRACT: *With this article the authors are trying to briefly present the evolution of capital market risks associated with the use of financial instruments by economic entities. Over time, risk assessment methods have evolved, with the aim of providing accurate and timely information to decision-making. Understanding the uncertainty and risks affecting the process deployment helps improve decisions. If, in the 20th century, companies were preoccupied with dominating the economy and stock exchanges, in the 21st century the emphasis was on risk management and assessment in a holistic way. In the current economic context, the success of a business is a problem of adaptation to the environment, and the connection of an economic entity to the economic and social environment is a premise of their functionality. The conceptual evolution between the financial and accounting approach of financial instruments influenced their relationship to their use by economic entities in their elementary preoccupations (investment, financing and exploitation).*

KEY WORDS: *financial instrument, economic entity, risk, capital market, financial market.*

JEL CLASSIFICATIONS: *M21.*

1. INTRODUCTION

With the promulgation of Law 31/1990 on commercial companies, which provided the legal framework necessary for the birth and development of the capital companies and at the same time established a clear framework for the main products used on the capital market: shares and bonds - the premises for the emergence of the capital market in Romania. The first attraction of capital from the population was made by the banks: "Ion Tiriac" and "Bankcoop" - we can define 1990 as the moment of the emergence of the primary capital market.

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Over time, there has been a need for an alternative banking market, as the lack of placement alternatives has led to the proliferation of pyramid games, and their tolerance by the authorities, followed by their collapse, has generated confusion among individual investors.

Thus, the Ministry of Public Finance has created the minimum regulatory framework necessary for the start of the capital market in Romania, by elaborating the Regulation on the authorization of securities brokerage companies and securities agents approved by Government Decision no.788/1993.

In this context, an important category of operators - the authorized intermediaries - emerged as direct and exclusive participants in the conclusion of securities sale and purchase transactions, which created the premises of the Bucharest Stock Exchange and, later on, the Romanian OTC market.

Thus, in 1995, the Bucharest Stock Exchange was re-established by a decision of the Romanian Government, after a 50-year interruption, as an auction market. The year 1996 is marked by the creation of the RASDAQ market as a negotiating market. It ensures a free and intense circulation of securities at a negotiated exchange rate that reflects the interest of investors in the holding of unlisted securities.

In 1997, for the first time in Romania, the financial instruments appeared on the Sibiu Monetary Financial and Commodity Exchange through futures contracts, and in 1998 the options on the futures contracts with a complete series of useful derivative financial instruments for hedging and speculation operations.

On June 29, 2004, Law no. 297/2004 on the capital market, consolidated, in the Official Monitor, Part I no. 571 which regulates the establishment and functioning of the markets for financial instruments with their specific institutions and operations, as well as with collective investment undertakings. They aim to mobilize financial resources through investments in financial instruments and set the domestic legal framework in line with the requirements of the EU directives in the field.

Along with the development of financial markets, besides classical financial instruments, hybrids, bonds and hybrid instruments have been created that contain financial debt and equity instruments. Financial instruments are used by institutional investors as well as by individual investors or companies for whom the presence and trading of financial products on one or more financial markets has become a standard procedure for achieving investment objectives.

Initially, the concept of a financial instrument was in the form of a security asset, which later, through the debate on the financial and accounting issues of financial instruments, has seen new conceptual changes, financial instruments being considered new concepts that have developed financially and accountant after the notions of trade effects and representative titles of commodities were used which meant documents encompassing patrimonial values.

The factors that led to these developments were:

- the development of financial markets - in which financial instruments are used;
- the need to record as efficiently as possible their transactions and their financial result.

2. THE STRUCTURE OF THE FINANCIAL INSTRUMENTS

The financial and accounting approach of financial instruments on the financial market shares their structure, depending on the level of connection between their content and the market, in primary financial instruments and derivatives. The relationship between the two approaches to financial instruments has influenced their conceptual evolution in the concerns of economic entities to use financial instruments in investment, exploitation and financing. The emergence of certain normalization concepts (European continental conception, Anglo-Saxon conception, American conception) is due to current theories and accounting practices relating to financial instruments.

Financial instruments are recognized as assets, liabilities, equity instruments, forward contracts, futures, swaps, options or contracts that generate assets and financial liabilities. They are presented as negotiable securities that are traded on regulated markets and give patrimonial rights to the issuer.

At the level of the United States of America, there are three categories of instruments managed by economic entities:

- held to maturity securities - held to maturity securities instruments;
- trading securities - trading securities instruments;
- available for sale - available for sale instruments.

The accounting regulations of 2001 grouped tangible assets - according to the classification in the share capital of the economic entity issuing securities, as follows:

- participation titles;
- strategic titles;
- minority interests;
- significant investments.

At present, financial instruments are grouped in the balance sheet as follows:

- financial assets;
- short-term investments;
- loans from bond issue, with a separate presentation of convertible loans from bond issue.

Following the reorganization, the shares were structured into two categories, namely the monetary financial market (trade effects and representative commodity titles) and the capital market (the medium and long-term capital market) where the primary financial instruments can be found in a relatively large number (shares, bonds) and derivative financial instruments (options, futures and forward contracts deriving from primary financial instruments that stand on the financial market and have risk protection properties, helping to manage the portfolio effectively).

According to Directive 2004/39/EC of the European Parliament and of the Council, the financial instruments -, depending on the legal treatment and the place of trading - are structured in the following way:

- money market instruments (treasury bills, deposit certificates and trade effects);
- securities;

- futures, swaps, and interest rate and commodity options, as well as other derivatives that are represented by physical delivery or cash;
- participation titles that use collective investment undertakings;
- derivatives that help transfer credit risk;
- financial contracts on differences;
- other derivatives of rights, obligations, assets and indices that are traded on regulated markets as well as those that are regulated under another alternative trading system.

At the level of the European Union and the Markets in Financial Instruments Directive (MiFID) we find two categories of financial instruments:

- complex financial instruments (futures, swaps, options, financial contracts on differences, warrants and convertible bonds);
- non-complex financial instruments (participation securities in different investment funds, shares traded on a regulated market, various types of bonds and money market instruments).

3. THE RISKS OF THE TRANSACTIONS WITH THE FINANCIAL INSTRUMENTS

In the literature we come across definitions of the concept of risk, but one thing is certain, namely that we find in all definitions the specific elements of loss and uncertainty. It can be said that the risk creates opportunities, but it must not be omitted that the risk may cause economic entities to lose their business. The activity of an economic entity, money and financial interests quickly led man to think of the notion of "risk", starting from the fact that risk is an option, not a fate.

Many of our financial decisions involving a certain risk are taken individually, but individual financial risks can also be associated with costs for parties other than the venturer, outside and within the financial system. Thus, the creation and dispersion of financial risk can harm the individual as well as the economic entity as a whole.

Economic entities are conventionally defined as a complex and open system on the environment, being exposed to various risks. The pace of change induced by the globalization system has forced economic entities to use hedge funds, but also resources to manage them. Thus, the instruments used are called derivatives and provide sustainability and competitiveness to economic entities. Risk management in a globalized world is a strategic necessity and choice that manages the cumulation of financial and human information to reduce the vulnerability of economic entities.

The risk control procedures associated with the use of derivatives must address the many types of risks that we set out in Table 1.

When the investor chooses to risk for the assets he wants to hold, he allocates all the necessary resources to complete the transaction. Basically, risks are significant factors when choosing financial portfolios, which has led to a greater emphasis on risk management. A risk is an event whose occurrence is uncertain and the implementation of which affects the objectives of economic entities.

Table 1. Types of risk and their characteristics

No.	Type of risk	Characteristics of risk
1.	Strategic risk	- This occurs in situations such as: entrepreneurial conduct of traders in financial institutions, misinterpretation of customer requests, costs out of control, trading with inappropriate partners.
2.	Event risk	-interfaces in the situation where the issuer or the field in which it operates is preceded by an event that has a representative influence on the issuer's ability to pay the coupons.
3.	Operational risk	- represents the risk of financial loss resulting from misfortune, technical failure, or human error in operational management.
4.	The risk of changing the legislative framework	-this risk is present in transition countries wishing to make changes to the law in force;
5.	Business risk	- is defined as the risk that the dynamics of the variables that determine the business plan will reduce or eliminate the viability of the plan; is due to the unfavorable development of financial instruments that are found on the market;
6.	Credit risk	- is characteristic of the bond market; - is a counterparty risk and represents the risk that one of the partners will fail to complete the commitment, in part or in total, causing financial damage to the other party; - presents some key elements: the risk of interrupting your partner's payment; the risk of dispersal growth; the risk of decreasing yield.
7.	Price risk	- currency risk: - for bonds denominated in a foreign currency that pay the coupons in foreign currency; - there is some doubt about the amount of earnings in national currency produced as a result of the investment. - exchange rate risk - represents the risk that occurs when a transaction occurs at a scheduled date in a currency devaluing after this transaction; it is usually found on international markets; - market risk - or interest rate risk; Today's interest rates are instruments of economic policy and monetary authority to maintain the value of the currency in parity with other currencies, the financial system (especially the central banks) must intervene on interest rates, the business risk faces an interest rate related to the loan, greater or less; looks at the way in which the price of bonds becomes effective when interest rates rise; when bond prices rise, they lower interest rates; this risk has helped to develop hedging derivatives.
8.		- it is also called the funding risk; may occur when the company can not immediately sell a financial instrument at a value close to its fair value; occurs when it is not possible to

No.	Type of risk	Characteristics of risk
	Liquidity risk	quickly and without damaging the financial instruments at a favorable price; it may happen that at some point the company encounters obstacles in obtaining the funds needed to execute the financial instruments commitments;
9.	Cash flow risk	- is the fluctuation risk of the size of future cash flows associated with a monetary financial instrument; it may happen that the value of future cash flows attached to financial instruments is oscillating; these fluctuations occur when the actual interest rate changes to the instrument, without making a similar change and its fair value;
10.	Stock fluctuations risk	-intervence because the value of the shares is volatile, from which it follows that the risk of the business disappears due to these oscillations;
11.	Optimal investment risk	-is a specific risk that occurs when the investment is actually made
12.	Legal risks	- legal risk - is the ban on loans for use in derivative financial instruments contracts;
13.	Reinvestment risk	- when interest rates on the market diminish, and the income earned by the investor in the form of a coupon or as a repayment of part of the principal must be reinvested at a lower interest rate, thus reducing the overall return on investment.
14.	Rebuying risk	- It only intervenes on repurchased bonds and increases when interest rates are preceded by high volatility; in this situation, the investor has to invest the value received at a lower interest rate than the original one.
15.	Prepayment risk	- has about the same characteristics as the rebuying risk in the sense that if an interest rate cut occurs, the issuer may repay a portion of the loan ahead of time and the investor may reinvest the amount received at a lower interest rate than the original one.

Source: own projection

All economic entities have to apply best practices in risk management and risk management. As far as risk management is concerned, it can be seen as a set of activities that need to be coordinated so as to reduce risk to a level considered acceptable or tolerable, and risk management can be defined as a process implemented by the economic entity to identify possible events which can affect the activity and the entity itself and which can manage the risks through tools designed for this purpose.

From the literature study, the main categories of risks faced by financial instruments are: market risk, credit risk, liquidity risk, price risk, currency risk and legal risk. Derivatives are one of the means of risk spreading, which is a special type of marketable contract. The three types of derivative instruments (futures, options and swaps) are similar and offer a means of trading risk. Futures are standardized (i.e. can be traded on a stock exchange) contributing to increasing market liquidity. Option contracts offer the option buyer either to buy (call option) or sell (put option) the underlying asset at a specified price, either at the expiration date or over a certain period of time. Swaps are more recent financial instruments and are exchange arrangements. In the last thirty years there has been a substantial increase in financial derivatives, treasury bills and bonds have developed.

4. THE IMPORTANCE OF THE RISK ASSESSMENT IN THE ECONOMIC ENTITIES

In the last decades, the importance of risk measurement, monitoring and reporting has increased, subtracting the need for effective risk management. In any business environment, robust performance and risk analysis remain critical for asset and manager owners. Pressures from risk management regulations remain valid, and investors want more transparency and more frequent and detailed reporting.

Annual reports are the main method of disseminating information to investors and stakeholders. The reports are situations that accurately and completely reflect risk-related information and management methods. Increasing interest in risk management has led to the concern of economic entities to present their situations also from this point of view. Correct, complete and timely information is the foundation for effective risk management. Information should be directed to the right people to make important risk decisions.

It is therefore considered that risk reporting to investors and other stakeholders using financial statements of economic entities should include information that reflects the reality and can be the basis for financial decisions. The presentation of useful information on risks, following a communication plan, is an important step for economic entities, as well as a constant information point for users of financial statements. In a competitive economy, business failures are not unavoidable, and early warning of the risks that may arise in the work of economic entities can help prevent them.

In order to analyze how economic entities understood the International Financial Reporting Standards (IFRS) provisions, a number of economic entities were selected from companies listed on the Bucharest Stock Exchange (BVB).

The study was based on the following questions: *Are all economic entities subject to the same types of risk? Do the information presented in the risk reports differ according to the scope of the economic entities? Do economic entities provide quantitative information on the risks they are facing?*

The sample consisted of 20 entities for which the financial statements of 2016 were analyzed. Out of the total of selected entities, 10% of them provided general information on risk management policies. Figure 1 presents the risks to which economic entities refer in their reports.

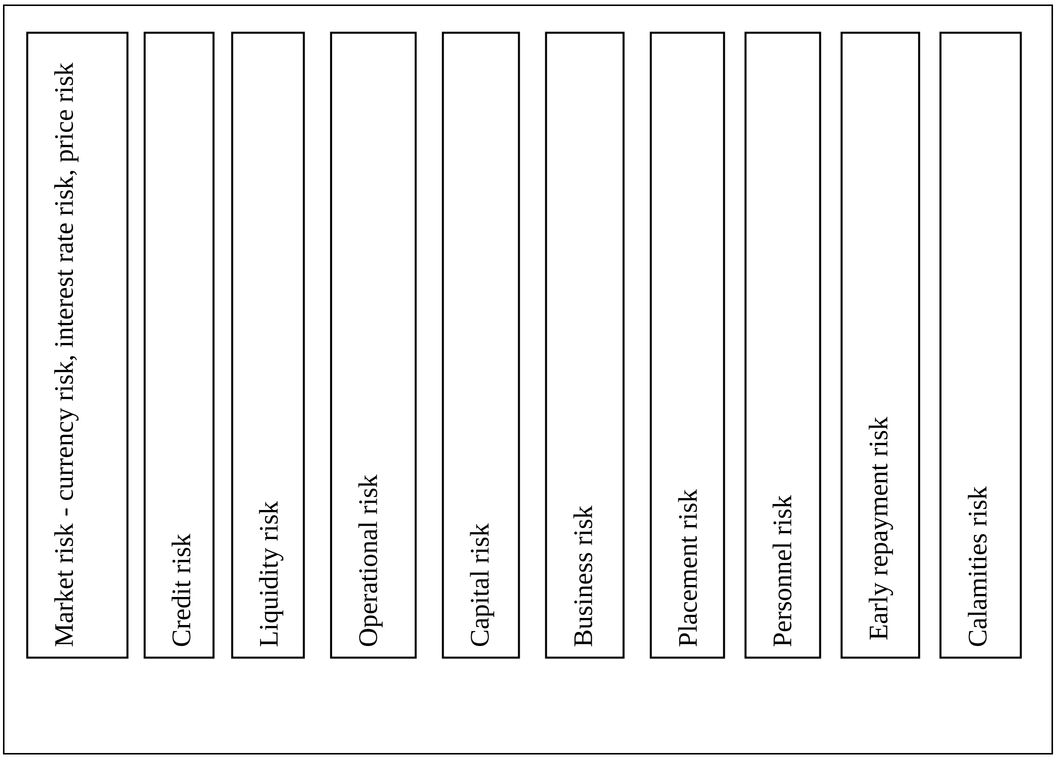

Figure 1. Types of risk reported by economic entities

Figure 2 shows the percentage of reported risks.

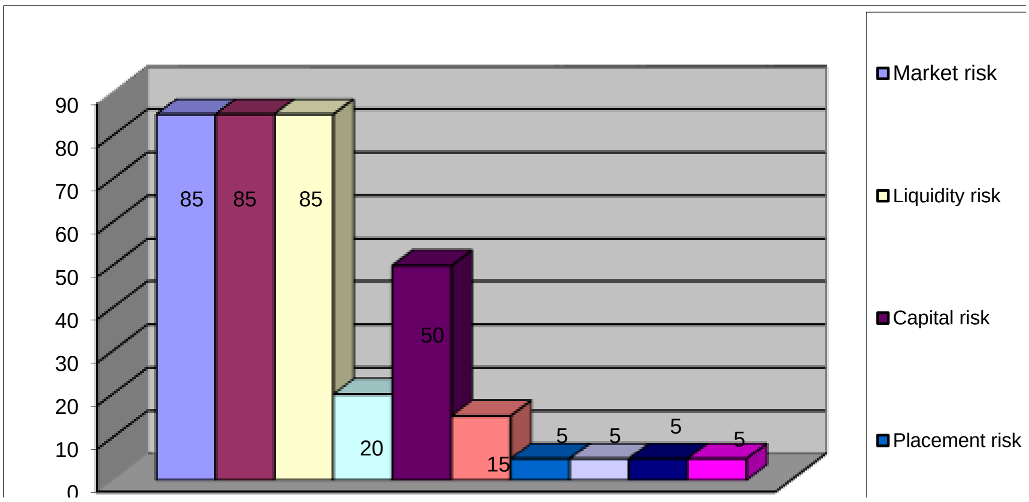

Figure 2. Percentage of risks reported by sampled economic entities

We noted that 85% of the economic entities included in the sample report information on market risk, credit risk and liquidity risk under IFRS, and 50% of entities report capital risk, the other risks identified in the reports being sector specific risks of the economic entities, namely the placement risk, the risk of early repayment, the risk of calamities.

The details provided for each type of risk reported differ from one report to another, with some companies providing quantitative and qualitative details of the risks to which it is exposed, as well as management methods, while others summarize the definition of these risks; and providing general details about their management. Of the sampled entities, 20% of the entities that do not provide quantitative information for any risk were identified.

It has also been found that the most frequent qualitative information provided to users of financial statements is sensitivity analyzes (recommended by IFRS7), net exposures, maximum risk exposures, indebtedness and presentation of debt maturities. Each type of risk reported by each economic entity is found in the financial statements. The methods identified for each financial risk are presented in Table 2.

Table 2. Methods of risk assessment in the economic entities' reports

Market risk	Sensitivity analysis; expenditure on financial hedging instruments; presentation of monetary items in lei and foreign currency; net exposure
Credit risk	Sensitivity analysis; expenditure on financial hedging instruments; presentation of monetary items in lei and foreign currency; net exposure
Liquidity risk	Presentation of the cash flow; analysis of financial liabilities by relevant maturity groups
Capital risk	Presentation of capital requirements; the degree of indebtedness

Of the methods presented, those referring to the maturity of debts are mainly used, followed by sensitivity analysis, net exposures and indebtedness. For each reported type of risk, economic entities use different methods of analysis and evaluation, and the information that emerges from them is included in the financial statements. In general, the focus is on market risk, credit risk and liquidity risk.

5. RESULTS

Over the past decade, the importance of economic entity measurement, monitoring and reporting processes has increased considerably, requiring the need for effective risk management. Managers and asset owners are aware that robust business performance is based on rigorous risk analysis.

The IFRS provisions on risk management are increasingly applied, investors seeking greater transparency and more frequent and detailed reporting. Increasing interest in risk management has led to investors' concern for presenting financial statements from this point of view as well. Since annual reports are the main method of disseminating information to investors and stakeholders, it is considered that they should also contain risk-related information and risk management methods.

Also, following the study, the authors found that the reports are detailed according to the field of activity of each economic entity and therefore differ from one economic entity to another. Another aspect is that, although risk reporting is an important aspect for investors, some economic entities only provide general information. In view of this, the authors consider that for the optimal comparability of the reports submitted by various economic entities, a minimum amount of quantitative information should be set so that users of the financial statements can form an overall idea of the management activity risks within an economic entity.

6. CONCLUSIONS

Risk is defined as an event whose occurrence is uncertain and whose implementation affects the objectives of the economic entity. The definition of risk clearly results in the notion of vulnerability of the economic entity, and therefore all economic entities have to apply best practice in risk management, especially since the number of large firms' bankruptcies raises a number of issues and questions about the effectiveness of current practices in the prevention of various risks. It is necessary to distinguish between the concepts of risk management.

Risk management can be defined as a set of coordinated activities to reduce risk to a level considered acceptable or tolerable, and risk management is a process implemented by the economic entity to identify possible events that may affect the organization and manage risks through instruments designed for this purpose. Managing risks in a globalized world is therefore a strategic need and choice that must mobilize all human and financial information so that economic entities are no longer vulnerable.

The main categories of risks faced by financial instruments are: market risk, credit risk, liquidity risk, price risk, currency risk and legal risk, but we must not omit systemic risk and costs. Awareness and fairness assessment of financial risks is a key point in the management of an economic entity.

As a result of the study, it is possible to admit that the financial risks contained in the annual reports of the economic entities are different, generally the entities report the market, credit and liquidity risk. These reports are detailed according to the scope of each economic entity. Also, in all activities irrespective of economic order, the risk is inherent, so the key concern is not whether the risk element is present in a particular activity but how they are managed because the risk can not be totally perceived as a negative thing, as long as it creates investment opportunities and contributes to the good functioning of an economic entity's activity.

At economic entity level, risk may be reduced or may remain the same in the sense of being transformed and transferred. An important role in this process has the professional accountant by understanding the entity's risk universe and by using tools to keep management aware of them. Also, risk analyst is the one who conducts numerical analyzes and informs them. Methods of assessing financial risks have evolved with the development of economic activity, and their importance is becoming more and more aware. The need for risk information has led to a change in the way financial reporting is made.

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