
Perceptions and Trends Following the Application of IFRS in Romania

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Abstract

An IFRS-based accounting should provide many advantages, both from the point of view of presenting and reporting financial information, as well as from the point of view of decision-making processes, giving companies the opportunity to use the global financial markets to raise capital.

In this context, the objective of this research was to identify the perceptions and trends of the Romanian companies' executive directors as a result of applying international financial reporting standards, especially to identify if the application of IFRS created the opportunity to attract external financing sources at the level of Romanian companies.

Most respondents are aware of the benefits that companies should get when applying IFRSs. Thus, 96% of the interviewed managers consider that the main advantages offered by the application of IFRS consist, on the one hand, in increasing the level of transparency and comparability of financial information at international level, and, on the other hand, in increasing the role of accounting in the decision-making process. Such advantages should lead to the increase of the confidence of the potential foreign investors in the Romanian companies and subsequently improve the investment process in the Romanian companies, a benefit that, at the moment, the Romanian entities seems to not get yet.

Keywords: IFRS; accounting; external financing sources; foreign capital; domestic capital

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Introduction

In Romania, in mid-2012 the Minister of Public Finance issued Order no. 881, by which the companies listed on the Bucharest Stock Exchange (BVB) were obliged to prepare and report the financial statements in accordance with the International Financial Reporting Standards (IFRS) starting with the end of 2012.

In the same year, at the conference "Investor Information and Transparency. IFRS Standards" organized by Deloitte in partnership with Bucharest Stock Exchange, Pompei Lupsan, Vice-President of the Board of Directors of BVB, stated that for companies listed on BVB it is important to apply IFRS when preparing individual financial statements for at least 3 reasons, namely¹:

- IFRS ensures the increase of the transparency of the reporting according to the Corporate Governance Code of the BVB;
- It is easier for investors to perform comparative analyzes for companies in the same field, but from different capital markets;
- The IFRS-based accounting system is a standard analysis tool preferred and known to foreign investors, giving them confidence in public financial information.

All these reasons for applying IFRS support medium and long-term liquidity growth at the level of Romanian companies (Deloitte, 2012).

After approximately 7 years since this declaration and since applying IFRS by Romanian entities, we consider it important to capture the evolution of these companies in these years and to investigate whether the change to an IFRS based accounting generated the expected benefits.

Theoretical framework

Regarding the perception of the application of IFRS, a series of studies have been carried out over time in order to know the advantages and disadvantages of applying this system. Thus, at an international level, Dennis Taylor's study that aimed to analyze the effects of adopting IFRS on

¹ http://www.banknews.ro/stire/62768_deloitte_audit_cand_pietele_de_capital_transcend_granitele_limbajul_universal_este_esentialimplicatiile_trecerii_la_ifrs_.html

the transparency and quality of accounting information of listed companies in Hong Kong, UK and Singapore concluded that the financial statements prepared under IFRS do not add significantly more value than the statements drawn up according to national standards, regardless of the level of accounting harmonization in the 3 countries (Dennis Taylor, 2009). Also, to the question mentioned by Pilcher and Dean in one of their qualitative researches: "does IFRS reporting add value to local management or government?", The response of the interviewed Australian directors seems to have been negative (Pilcher and Dean, 2013, p. 180- 196).

At the level of Romania, in a study carried out before switching to IFRS reporting by the listed companies, Ionașcu proposed to investigate the opinions of financial managers regarding the future application of IFRS. Following this study: 78.4% of the respondents considered that the application of IFRS will generate a higher level of comparability in the financial statement at international level; 86.5% of the respondents considered that the information obtained from the financial statements reported in accordance with IFRS are more qualitative, offering much more relevant information to the investors; more than half of the financial directors (56.8%) argued that reporting according to IFRS provides a better information source for managers in making economic decisions; 40.5% of the directors agreed with the idea that IFRS will facilitate access to financial markets (Ionașcu et al., 2011).

Also, Dănescu and Spătăcean, before the implementation of IFRS by the listed companies, stated that following the adoption of IFRS the companies will be stimulated to improve the quality of their financial reports in order to consolidate their competitive position on international financial markets (T. Dănescu, O. Spătăcean, 2011).

With respect to the results obtained after 7 years implementation of IFRS, through our study we intend to continue the research at national level, by investigating the perceptions of the managers regarding the consequences of applying IFRS.

The observation and analysis of the phenomenon on Romanian companies is even more significant if we take into account the specific economic and legal context of Romania.

First of all, it should be borne in mind that the International Financial Reporting Standards have their bases and origins in Anglo-Saxon law (customary law), which can create difficulties in applying them in countries

with different legislative contexts, such as Romania, based on norms of Roman law.

Secondly, if we compare Romania's economy with other states, according to the opinions of international rating agencies, Romania would fall into the category of emerging countries. The theory says that emerging countries would be more open to the application of internationally recognized regulatory frameworks, such as IFRSs. However, in the research literature there are also opinions that consider that the respective international norms do not fully reach their objectives at the level of emergent countries, as some difficulties appear both in the adoption and implementation of the standards, as well as in satisfying the information requirements, because on the market there are not present all users of information. In this sense, both in the Romanian literature, but especially in the international literature, one can observe the increasing acute concern of the specialists to understand why the decision to apply IFRS in the emerging countries is taken into account, given the difficulties and obstacles encountered in the implementation process. This concern is also found at Albu, so that the implementation of IFRS is complex and requires the revision and improvement of many aspects, such as: the characteristics, the attitudes of the Romanian companies, the perspective and the characteristics of the Romanian accounting system, the expectations of the users of the financial statements, the characteristics of the Romanian accounting profession (Albu et al., 2011).

Although there is a concern in the specialized literature regarding the application of IFRS in Romania, however, the complexity of the phenomenon requires continuous theoretical and methodological research in the field.

By reviewing the specialized literature and past research on international accounting standards, we concluded that although each country could build an accounting in accordance with its needs, however, this aspect could be a hindrance for foreign investors, for entities which cooperates with subsidiaries from other countries or with parent companies internationally or in the case of entities present on foreign capital markets. Thus, it turns out that the internationalization of accounting can facilitate the worldwide collaboration of entities, through comparability, transparency and an easier understanding of the information presented by the entities, however, all at a certain cost.

Research methodology

Our study was based on a questionnaire constructed in order to obtain relevant opinions of the representatives of the companies applying IFRS. For our survey we have chosen entities that apply IFRS, the majority being companies listed on the BVB on the main market and thus we have included all 24 entities in the *Premium* category and the 3 companies listed in the *International* category. As a rule, these companies are representative, being the largest and most important listed entities, which qualify for the higher criteria imposed by the BVB. Also, our study in addition to these large companies also included 20 other entities applying IFRS.

The response rate to the questionnaire was 53% and the answers received were introduced and processed in Excel and Stata.

Defining the research hypotheses

Given the main objective of this research, the first assumption set was the following:

H1: The application of IFRS at the level of the Romanian entities facilitates external financing.

We also wanted to surprise if after applying IFRS the Romanian managers became more interested in using the accounting information in the decision-making process. To answer this question, we established the second hypothesis:

H2: The role of the accounting system has increased in the decision-making process with the application of IFRS.

Moreover, we wanted to see if the application of IFRS involved an additional effort in the activity of the entities. Therefore, we set the third hypothesis:

H3: The application of IFRS entails additional costs.

Results

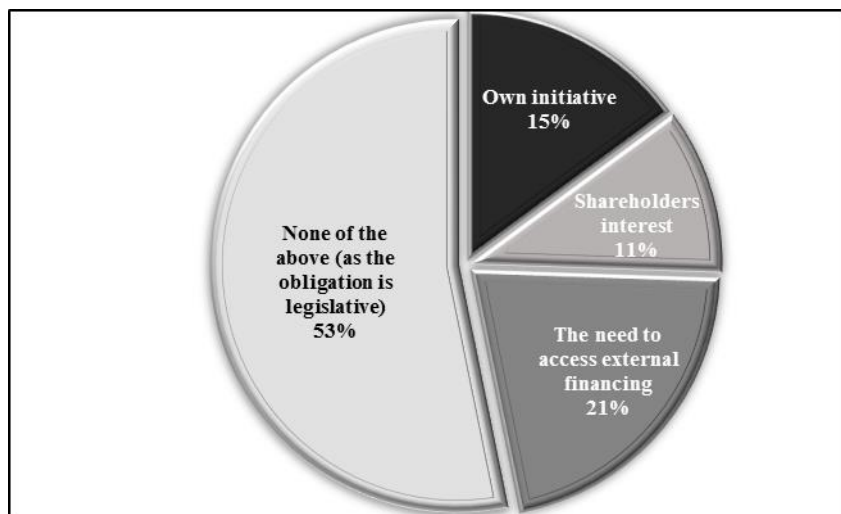
From our sample, which comprises 47 companies, we found that all 47 entities apply IFRS.

We know that the application of IFRS in Romania arises from the legislative obligation, but in addition we wanted to know if the entities would have been interested in this accounting system if this requirement had not existed. Thus, we found that 53.2% of the financial directors stated that

they would not have applied IFRS if they had not been imposed, but the remaining 46.8% of the entities would have applied IFRS for other reasons (*Figure no. 1*), such as: own initiative

(14.9%), shareholder desire (10.6%), better access to external financing (21.3%). However, overall, the reason for applying IFRS based on legislative obligation predominates.

Figure no. 1. Reasons for applying IFRS

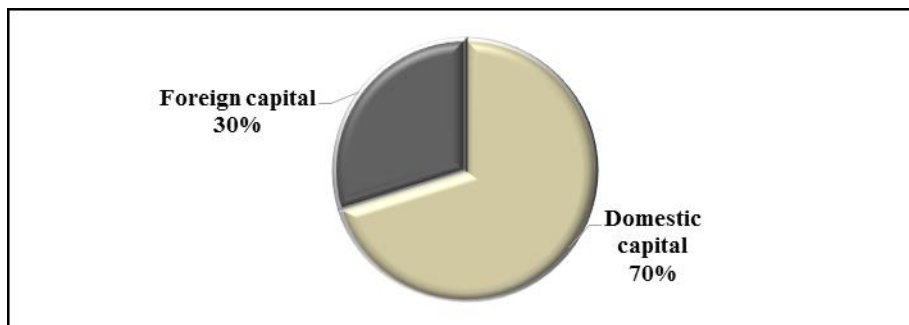


Source: Own projection

In addition, we wanted to analyze the shareholding structure of companies that apply IFRS, respectively companies owned by foreign investors versus companies owned by domestic investors. We observe in *Figure no. 2* that currently out of the total sample of 47

companies, 70.2% are majority owned by domestic investors, while 29.8% are owned by foreign investors. It is possible that this structure of capital at the level of Romanian companies to generate a low interest in the application IFRS.

Figure no. 2. Domestic capital vs. foreign capital at the level of the Romanian companies



Source: Own projection

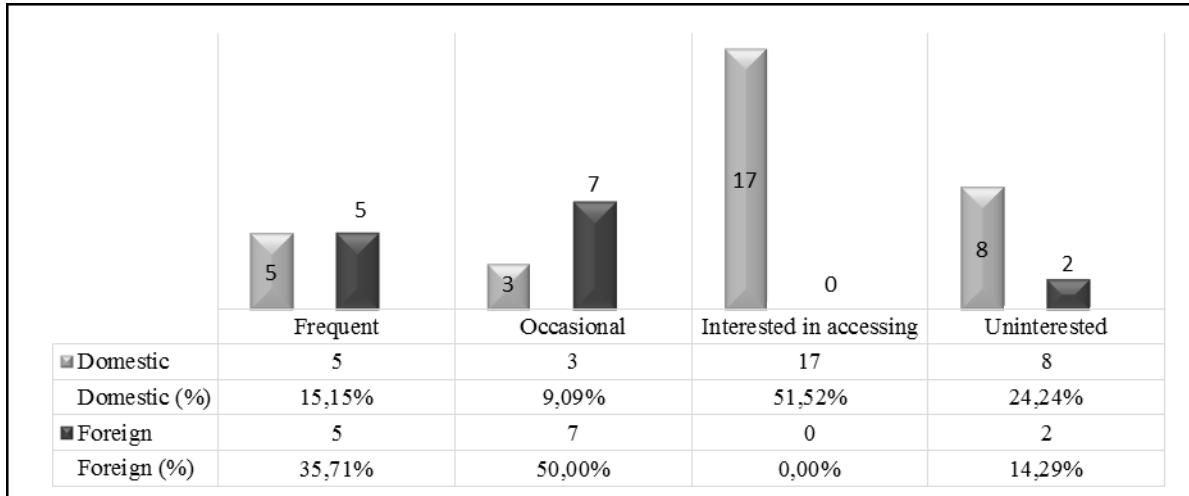
Also, in the analysis of the first hypothesis, we wanted to know if the shareholders of the interviewed companies

consider that the financial statements based on IFRS helped them in attracting external financing.

Thus, in **Figure no. 3** we notice that the companies owned by foreign investors used the external financing sources more frequently than the domestic companies.

The domestic companies want to access such sources, but at present only about 26% manage to do so frequently and / or occasionally.

Figure no. 3. Frequency of access external financing by Romanian companies

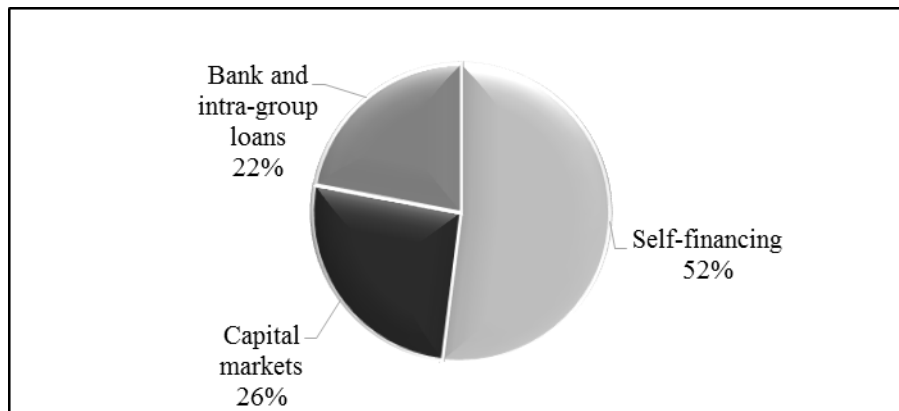


Source: Own projection

Starting from the frequency of accessing external funding, the research results become more conclusive if we identify the nature of the main financing sources used by the companies applying IFRS. Thus, following the results in **Figure no. 4**, we can see that capital markets are far from being the main source of financing for the companies in our sample. Self-financing is on the

first place, followed by the capital market and with little difference from it, bank and intra-group loans, which, as a rule, also involve a cost of borrowing. This prudent behavior in attracting sources of financing from the capital markets is characteristic to the continental countries, which do not have sufficient force to convince investors.

Figure no. 4. The main source of financing used by the Romanian companies



Source: Own projection

In this situation, in view of the above results, according to which, on the one hand the respondents stated that the predominant reason for applying IFRS is a mandatory one, and on the other hand the companies owned by the local investors, majority in Romania, do not consider the IFRS application appropriated in attracting external financing sources, we have all the prerogatives to not validate hypothesis 1. Further, by correlating the responses received in connection with the possibility of IFRS to ensure greater access to external financing, we find both in **Table no. 1** and **Table no. 2** (presented below), that the main reason for applying IFRS among Romanian entities is not the need for external financing.

In order to validate or not the second hypothesis, we wanted to know the perception of the managers regarding the benefits associated with the implementation of IFRS. Thus, in **Table no. 1** it is noted that most of the respondents agreed that following the application of IFRS, a number of advantages were obtained regarding: transparency, comparability and intelligibility of financial information, professional opportunities etc.

Regarding the increase of the role of accounting in the decision-making process, 81.8% of the respondents claimed that with the application of IFRS the accounting information was much more useful to the decision-makers. Thus, we can accept hypothesis 2.

| Statements from the questionnaire | Level of approval of the statement (%) |
|---|--|
| IFRS provided a clearer and more accurate picture of the financial statements | 80% |
| The application of IFRS increased the level of transparency of the financial statements | 96.9% |
| The application of IFRS has increased the level of comparability of financial statements at international level | 96.3% |
| Financial statements reported in accordance with international standards are easier to understand | 76.4% |
| With the implementation of IFRS, the role of accounting has increased in the decision-making process | 81.8% |
| The application of IFRS decreased the cost of capital | 20% |
| The application of IFRS offers Romanian accounting specialists' opportunities at international level | 90.9% |
| The application of IFRS ensured the attraction of new investors | 35% |

Source: Own projection

When validating hypothesis no. 3, combining the answers received regarding both the benefits and the challenges of adopting IFRS, we note that the respondents did not agree with the fact that the implementation of IFRS reduced the cost of capital, as only 20% of them agreed with this statement. Moreover, other current expenses related to the IFRS transition and application have not diminished, but, on the contrary, have seen a significant increase, such as: expenses with retreats and adjustments of financial statements, with the training of the personnel in knowledge of IFRS, expenses for controlling and auditing information reported in accordance with IFRS, expenses for reorganizing the operational and IT infrastructure of companies, etc. These issues resulted

as well from the answers received to the question regarding the challenges encountered by the respondents in applying IFRS (**Table no. 2**).

Also, the answers regarding the challenges associated with the implementation and application of IFRS are very diverse (**Table no. 2**). For example, 52.8% of the respondents considered that the transition to IFRS implementation was complicated, 92.7% considered that the training of the personnel was a high cost challenge, 74.5% are skeptically regarding the reorganization of the operational and financial process, and 52.8% are afraid of the changes caused in the IT infrastructure. Given the perception of the respondents regarding the difficulties encountered and the increase of the costs following the application of IFRS we can accept hypothesis 3.

Table no. 2. Respondents' perception of the challenges encountered in the effective adoption and application of IFRS

| Statements from the questionnaire | Level of approval of the statement (%) |
|--|--|
| The switch to IFRS was complicated | 52.8% |
| The application of IFRS will never reach a single global reporting system | 21.9% |
| Staff training | 92.7% |
| Changes in the operational and financial process | 74.5% |
| Changes in IT infrastructure | 52.8% |
| Internal control and audit of reported information | 73.2% |
| Too much transparency | 30.9% |
| The concept of valuation of balance sheet items at fair value was difficult to apply | 67% |
| Changes in the legislative process | 70.9% |

Source: Own projection

Conclusions

The application of IFRSs should offer a number of benefits to the entities. Most respondents are aware of this, considering that by applying these accounting standards the image of companies has improved (80%). Also, 96% of the interviewed entities consider that the main advantages offered by the application of IFRS consist, on one hand, in increasing the level of transparency of the financial position and in ensuring the comparability of information at international level, and on the other hand in a better understanding of the financial statements and in increasing the role of accounting in the decision-making process. Such advantages should lead to the increase of the confidence of the potential foreign investors in the Romanian companies and subsequently improve the investment process in the Romanian companies, a benefit that, at the moment, the Romanian entities seems to not get yet.

As a result of this analysis, the first general assumption valid in several jurisdictions of developed countries with strong capital markets was rejected, namely that listed entities that apply IFRS attract new investors more easily.

Although at present the Romanian practice does not confirm the advantage of attracting new investments in the entities applying IFRS, however the creation of a legislative framework by which listed companies must apply IFRS is a necessary measure for Romania as a member of the European Union.

When we've looked at the source of capital of the companies analyzed, we conclude that companies that

are wholly or mainly owned by foreign investors are most interested in using IFRS. This behavior is especially justified since 2007 when Romania became a member of the European Union, and the Romanian markets have increasingly opened to foreign investors. At present, there are many multinational companies operating in Romania and their number is likely to be constantly increasing, given that Romania offers a lower labor cost than other European countries. In this context of business convergence and globalization, it is absolutely necessary that the Romanian legislative framework to comply with the European and international rules.

Another hypothesis for which the application of IFRS is useful to the listed companies would have to do with the very basic objective of these companies when they decide to operate on a regulated capital market, namely to have permanent sources of finance. We know that investors in the capital market would not make available the liquidity they have if the issuing entities would not provide a transparent and stable framework for presenting the financial position and performance, as it ensures the application of IFRS.

Even if the application of IFRS is compulsory for the listed companies, these criteria seems to still be insufficient for the Romanian companies in attracting liquidities from the capital market. From the research carried out we have noticed that Romanian companies use self-financing as the main source of financing, and the other external sources, respectively loans and the capital market, are currently offering a low level of financing.

The results of our study are in accordance with the opinions found on this subject in specialized literature. Thus, Romania is a country in which the culture of the financial market is in an incipient phase of development and consolidation and therefore, the listed companies manage to finance their activity, mainly from loans and own resources.

The mechanism established by IFRS is, of course, in a continuous process of adaptation and development, according to the evolutions and requirements revealed in practice. For example, as it is known, in the last years IFRS 15 "Revenue from customer contracts" and IFRS

16 "Leasing contracts" have been issued and are being implemented. There are evolutions that pose technical and operational difficulties for professionals. Therefore, they will be the subject of future research.

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