IFRS IN EMERGING ECONOMIES: THE GLOBAL PERSPECTIVE AND THE CASE OF ROMANIA

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Abstract- Creating a unitary set of financial reporting standards universally applicable became an area of focus for the users of the financial statements over the last decades. The importance given to this idea increased together with the efforts put in the process of harmonization, also accelerated by the growing interest shown by the international investors in the emerging countries as identifying these as areas for their potential investments. The purpose of this article is to highlight and present some evidence regarding the conception about the adoption of the International Financial Reporting Standards in the emerging countries and also to present some advantages and disadvantages identified in terms of applying IFRS in comparison with the application of the national legislation for financial reporting. A separate section is dedicated for the case of Romania in which the current status in terms of aligning with IFRS is analyzed. This article represents an additional contribution to the prior research performed regarding IFRS implementation in the emerging economies, which is still limited, and emphasizes the case of Romania which was lately subject to changes in terms of financial reporting standards and about which, to our knowledge, a significant analysis of the new status after the issuance of the new regulations is not yet available in publications.

Index Terms- Advantages, Disadvantages, Emerging, IFRS.

I. INTRODUCTION

The interest shown and the efforts involved in creating a single set of financial reporting standards universally applicable increased lately together with the importance given to the idea of harmonization of the financial reporting requirements. One of the main reasons for this is that the accounting information presented in accordance with the local standards is not always in line with the market players’ needs [1] and, also, for a foreign investor, the existing inconsistencies between the national accounting systems represent a significant obstacle in understanding the financial information presented by other countries [2]. Starting 2005, all entities listed in The European Union are required to prepare and issue the financial statements for their consolidated accounts in accordance with the accounting standards issued by the International Accounting Standards Board (IASB). Nowadays, IFRS became the most common set of reporting standards used worldwide, with more than 120 countries which already adopted IFRS at different stages, according to AICPA (2014)[3].

II. RESEARCH METHODOLOGY

The ideas presented in this article are based on the research performed in the area of IFRS implementation in emerging economies and on the corresponding results included in recent publications by specialists, while the personal view of the author is also involved on specific matters. For the case of Romania, the analysis is made by scrutinizing the requirements of the new regulations issued for the financial reporting (OMFP 1802/2014) and by comparing several specific treatments with the ones required by the International Financial Reporting Standards.

III. THE CURRENT GLOBAL CONTEXT REGARDING THE IFRS ADOPTION IN THE EMERGING COUNTRIES

The research performed in the accounting area of the emerging countries became more intensive, correlated with the increase of the economic interest in such markets [4] and the process of adoption of IFRS as financial reporting standards was accelerated during the recent years in these economies [5].

There are several sources of the international accounting research which argue that the standards based on the environment of developing countries is not completely suitable and useful for the emerging economies. There are some arguments about IFRS being irrelevant for the developing economies, but their adoption is scoped for their “network effects” [5]. According to Kosonboov (2004) as cited by I. Alsaqqa and N. Sawan, it is argued that the specific needs of the developing countries may not be taken into consideration by the IASB, an example being the fair value method used if applying IFRS which several developing countries cannot obtain because of the lack of asset market valuation [6]. It is also indicated, as argued by Perera (1989a) cited in the same source, that the information produced according to the accounting standards of a developed economy will not be useful for the decision process in a developing economy [6].

However, recent research is oriented more towards the positive impact of adopting IFRS even in developing countries. A study performed in order to analyze the European market reaction to IFRS adoption shows that, although there is a less positive reaction encountered for the companies from code law...
countries, there is a higher positive reaction generated from companies with lower quality in terms of accounting information in the pre-adoption period, basing on the expectation that the IFRS adoption will lead to a better presentation of accounting information and, also, a higher positive reaction came from the companies which dealt with information asymmetry during the pre-adoption period, expecting that this issue will be mitigated after adoption\(^{(7)}\). The application of IFRS is perceived as providing high quality to the financial information, in comparison with the results of the application of the most local accounting standards, leading to the increase of the level of comparability of the financial statements used by investors, especially considering that nowadays the investors are seeking investment opportunities everywhere and a lot of companies extend their operations in several jurisdictions, crossing their national borders\(^{(5)}\).

However, the research in terms of accounting for the most of emerging countries is still not as wide as the one performed for developed countries. This is also the case of countries from Central and South-Eastern Europe, where there are limited resources available to enhance the accounting research, considering issues like the difficulty of accessing the information, the lack of databases, the lack or low level of relevance of the country’s accounting experience for the international audience, while several existing publications are not available in languages of international use\(^{(4)}\).

For a successful implementation of IFRS in an emerging country it is important to consider the existing challenges and to assure these are properly and sufficiently addressed or mitigated. As F. Saidi (2013) argues in a study about IFRS implementation in Algeria, that the challenges which may occur in the process of converging with the IFRS must be completely recognized and addressed in order to assure that the desired objectives of the process will be successfully achieved\(^{(1)}\) and to benefit of all the advantages that the implementation of IFRS would bring.

IV. ADVANTAGES AND DISADVANTAGES REGARDING THE IFRS ADOPTION IN THE EMERGING COUNTRIES

Being aware of the advantages and disadvantages brought by the transition from the local requirements in terms of financial reporting to IFRS is essential for an emerging country being in the process of transition, in order to obtain from the beginning the maximum benefit from the advantages, to be prepared to mitigate the impact of disadvantages and to successfully overpass the challenges. The experiences of the emerging economies that started to apply IFRS can be used as lessons for other countries in the process of transition.

A. Advantages

A summary of advantages of adopting IFRS identified in several emerging countries is presented below.

- **Improvement in the quality of financial reporting**

According to the findings of I. Alsaqqa and N. Sawan (2013) who presented the results of their study aimed to assess the impact of adopting IFRS by companies listed on the United Arab Emirates stock market, 77% of the respondents to their questionnaires considered that the reliability of the financial reporting increased, 73% noticed the improvement of the level of understanding and 71% believed that the relevance of the financial information improved since the introduction of the international standards\(^{(6)}\). Another research performed in this area shows that the A-share companies from China registered a significant improvement in the quality of the financial reporting after the substantial convergence with IFRS\(^{(8)}\). The results of a study regarding the Mexican GAAP adaptation to IFRS also show that “in general, the adaptation to IFRS evidences an improvement in accounting quality with regards to convergence in pre- and post-adaptation period\(^{(10)}\).” Research on the effects of IFRS adoption in the case of Turkey also present positive impact on the accounting information, as, “according to the research findings, value relevance and accounting quality has been improved for Turkish listed companies by IFRS application”\(^{(9)}\).

- **Improvement in the level of comparability of the financial statement**

In a study performed in order to assess the benefits of applying the new local accounting standards in Malaysia required to be implemented starting 2006 which are aligned with IFRS, it is claimed that, in average, the majority of the participants at the research agreed that the adoption of these standards would improve the comparability between the financial statements of several companies, this also eventually leading to the increase in the level of the investors’ confidence in the accounts of the Malaysian companies resulting into a better access to foreign capital\(^{(11)}\). The “easy comparability” of the financial statements prepared according to IFRS of companies worldwide is also a benefit noticed for the case of Nigeria\(^{(12)}\). An analysis performed on the IFRS implementation in Poland also shows an increase in the international comparability of the financial statements as a result of this process, in the case of listed companies\(^{(13)}\).

- **Increased level of transparency**

The implementation of IFRS in the case of the Polish listed companies “increases the reliability, usefulness and transparency of financial reporting”\(^{(13)}\). The study performed in the United Arab Emirates shows that
almost 60% of the respondents noticed benefits in terms of disclosure, since the introduction of IFRS [6].

The same opinion was overall drawn in Malaysia, regarding the new local standards aligned with IFRS, being argued that this change would lead to a higher level of transparency in terms of reporting [11].

- **Benefits from the use of Fair Value**

Using the fair value concept as valuation method is seen as a benefit in the case of India, as this “can help Indian firms to reflect their true worth of Assets held in the financial statements” [14]. The findings obtained within the United Arab Emirates show that although most of the respondents were worried regarding the fair value concept applied within UAE at the adoption of the IFRS, the majority believe in the benefits brought by the fair value method in comparison with the one involving the historical cost [6].

- **Flexibility**

For countries applying U.S. GAAP or local standards which are rules-based, the transition to IFRS would bring more flexibility in accounting treatment and disclosures, depending on the nature of each specific transaction and the corresponding circumstances, as these are generally principles based. For the case of Ukraine, it was noticed that the attempts of applying IFRS led to a decrease in the number of strict accounting rules and regulations explained by the “multipage instructions” replaced by “concise standards” [15].

- **Cost savings**

Another advantage of adopting IFRS would be for the multinational companies that have to issue several sets of financial statements, depending on the number of frameworks these have to comply with from various countries. Having a unitary set of standards applicable for several countries would decrease the number of sets of financial statements to be prepared and thus, would reduce the reporting costs, although significant transition costs would occur for the first time reporting. This benefit is also identified in the case of Nigeria, where it is claimed that the use of IFRS will lead to a low level of costs in terms of reporting, generated by a “common reporting system” [12].

B. **Disadvantages and challenges**

The new financial accounting system of Algeria which had to be implemented starting 2010, recommends the preparation of accounting information in accordance with the international accounting standards [1]. The challenges mentioned for the change in the accounting system would be the resistance to change, the absence of a real and active accounting profession, low quality and few updates brought to the education process in terms of accounting, the absence of accounting and legal infrastructures suitable to support the new international standards [11]. Such challenges are broadly applicable for emerging and developing countries. For example, the infrastructure issue would be common for the countries where institutions like those operating in the area of economy or administration have their basis in the “centrally planned economy” period, during which the levels of transparency and bureaucracy were very low [11], in comparison with the characteristics promoted by the international accounting standards.

A summary of the disadvantages of adopting IFRS identified in several emerging countries is presented below.

- **Challenges for the use of Fair Value**

The issues regarding the use of fair value within UAE are common to several emerging countries. The fair value is difficult to be measured within environments with no active market, few or lack of certified persons to perform the valuation and to manage the valuation methods [6]. The importance of this challenge is given not only by the cases of impossibility of establishing the fair value, but also by the fact that the valuation can be mistaken leading to overstatements or understatements that can influence the decision-making process. In a research performed to assess the comparability between the Czech accounting regulations and IFRS it is also concluded that the most important inconsistency is related to the measurement bases and the application of historic cost, fair value and present value, also emphasizing the difficulty of measuring fair value within markets which are less transparent [16].

- **Lack of relevant knowledge and practical experience**

A study performed by N. Masoud examining the variables affecting the decision to adopt IFRS by several emerging market economies concludes that an obstacle met during the adoption process can be the absence of the technical skills needed [3]. This is mainly caused by the lack of practical experience and by the unavailability or limitation of proper training resources. The same issue is also identified in the case of Libya, where for adopting IFRS, the absence of technical skills and the inadequate knowledge among the professional accountants represent one of the several obstacles encountered [17].

- **Training and consultancy costs**

Because of the lack of knowledge and practical experience mentioned above, training programs and consultancy services have to be rendered in order to obtain a sufficient and proper level of knowledge to correctly fulfill the requirements of the new reporting standards. This issue is noticed also when assessing...
the challenges of IFRS adoption in Libya [17]. The same issue was also identified in the study performed in Malaysia where higher financial costs are expected to be generated by the need of engaging an external specialist and of staff training [11].

• Accounting systems

For the successful adoption of a certain set of reporting standards, it is essential to also adapt the accounting systems in order to support the new requirements. N. Masoud shows based on the analysis performed on several emerging countries that difficulties may be encountered in developing high-quality accounting systems [3]. The study performed regarding the Malaysian accounting standards aligned with IFRS has similar results, as higher costs are expected to occur for upgrading the accounting systems [11].

• Transition costs

For the first time adoption, the transition costs may be significant, leading to the perception that the transition to IFRS would be less cost-effective and efficient than maintaining the local accounting regulations [18].

V. THE STATUS OF ROMANIA IN TERMS OF ALIGNING WITH THE INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Romanian experience in terms of applying IFRS has been enriched since 2012, through these becoming mandatory for the individual financial statements of the listed Romanian entities. This comes after, starting 2007, the IFRS as adopted by the European Union were required for listed groups and for banking institutions [4]. The overall process of IFRS implementation in the case of Romania can possibly be considered the most complex process the specialists have to deal with since the beginning of the accounting reforms, after 1990 [19].

The IFRS application in preparing the financial statements is still in early stages. Because of the short term available for the transition to IFRS, the impact of the first time adoption could not have been fully integrated into the budgeting or forecasting process, possibly leading to unexpected impacts on the financial statements and to lack of fulfilling the targets assumed according to the approved budgets and forecasts, previously agreed with creditors, shareholders and other financial statements users [20].

Drawbacks related to the transition process may be the fact that the IFRS suffer quite often changes which may create the feeling of instability, leading to the preference for using more stable concepts, the continuous need of involving specialists in the process in order to define and implement specific procedures for IFRS implementation, the need of understanding by the management and accountants of the fact that the collaboration in this transition is essential and of the corresponding powers and responsibilities in this process, the difficulties encountered because of different cultural values and systems, the complexity of the standards that lead to difficulties in understanding and application [2].

On 1 January 2015, an update of the national regulations in terms of accounting and preparation of the annual financial statements was made, by entering into force of OMFP 1802/2014. The new stipulations present several accounting treatments more close to the ones required according to IFRS. Among these, there can be mentioned the treatment of the decommissioning provision for assets, which is taken over from the requirements of IFRIC 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities, being mentioned the two models of valuation, cost based model and revaluation model, the changing of accounting policies that can be performed during the current financial period and for prior periods, which is also required if applying IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors and the treatment of the borrowing costs related to an asset which needs a substantial period of time to get ready for its preset use or sale, which is mandatory to be included in the production cost of the asset, this also being a mandatory condition if applying the requirements of IAS 23 Borrowing Costs.

However, there are still a number of inconsistencies between the treatment of the accounting information used in the preparation of the annual financial statements according to the Romanian national legislation and the one in accordance with IFRS. An example of inconsistency is the treatment of the construction contracts, which according to OMFP 1802/2014 are not subject to a specific treatment, but the inventories category treatment is applicable also for these, while IAS 11 Construction Contracts is dedicated to the accounting and disclosures related to this type of elements, requiring separate presentation of the corresponding amounts in the category of Current Assets/Liabilities. The properties held for sale in the normal course of activity are included in accordance with OMFP 1802/2014 in the category of stocks, while if applying IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, these have to be separately treated and disclosed in the category of non-current assets, as Assets classified as held for sale (if fulfilling the corresponding conditions of classification mentioned by the standard). Several differences are also encountered in establishing the depreciated value, the starting period for depreciation, the interruption of the depreciation and the period affected by the change of the depreciation method. Certain specifications regarding the depreciation of goodwill are mentioned as per OMFP 1802/2014, while by applying IAS 36 Impairment of Assets, no depreciation should be charged for the goodwill, but it has to be subject to an annual impairment test. Different treatments are required by OMFP 1802/2014.
for the commercial discounts depending on the period of receiving the discounts and whether the corresponding inventories are still in stock or not, while according to IAS 2 Inventories, all commercial discounts have to impact the purchase cost of the inventories.

CONCLUSIONS

The research performed lately on the application of the International Financial Reporting Standards in the emerging economies tends to emphasize the benefits arising from the transition from local regulations in terms of financial reporting to IFRS. The improvement in the quality of the financial reporting, the increase of the level of comparability between the accounting information prepared by companies worldwide, the higher level of transparency, the benefit of using the Fair Value concept and the cost savings implied are only a part of the existing advantages. However, the disadvantages and challenges occurred were also noticed and needed to be considered. The challenging of using the Fair Value concept, the lack of relevant knowledge and practical experience, the implications of changing the accounting systems and the transition costs, including training and consultancy costs, are some of the issues that may occur in the transition process.

The experiences of the emerging economies in terms of IFRS application can be used as lessons for other countries in the process of transition. This can also be applicable for the case of Romania. The experience of Romania in applying IFRS increases based on the mandatory requirements regarding the financial reporting imposed by the European Union, but also together with the interest of the international investors of extending their businesses in the emerging markets. Several changes performed lately in the national legislation in terms of financial accounting and reporting seem to lead to the alignment with the IFRS on certain areas. The education in terms of accounting in universities also included aspects of International Financial Reporting Standards. However, despite all these, significant efforts are still needed to be made if bringing into discussion the option of adoption or aligning with IFRS. Important inconsistencies are still expected between the financial statements prepared according the national legislation and the ones issued in accordance with IFRS.

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