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PERCEPTIONS OF PREPARERS FROM ROMANIAN BANKS REGARDING IFRS APPLICATION

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ABSTRACT

Starting 1 January 2012, credit institutions are required to apply the International Financial Reporting Standards (IFRS) as basis of accounting for the preparation of the individual financial statements. Regulatory reforms were done and banks prepared to face the transition process. In this context, the aim of our study is to investigate, the perceptions of the main actors from banks (responsible with the transition process) on the cost and benefits involved by the use of IFRS as reporting standards (implementation strategy used by some banks before 2012) and on the peculiarities related to the application of IFRS as accounting basis (each transaction or event being recorded following IFRS requirements) immediately after 1st January 2012. We intended to investigate also if the transition process changed the attitude of banks towards the application of IFRS. We observed that preparers still have a positive attitude towards the application of IFRS considering that the cost benefit report is a positive one. Not all preparers are convinced that the conversion will lower the cost of capital. The complex nature of IFRS, the insufficient application guidance and the necessity to adapt to frequent changes of IFRSs were considered as difficulties related to IFRS reporting. Double reporting costs reduction and eliminating confusions by publishing two sets of financial statements were considered unanimously benefits of using IFRS as basis of accounting. It resulted that most preparers are concerned about the costs involved by the modification of internal evidence systems, the necessity to satisfy multiple reporting requirements (accounting, prudential and fiscal), the impact on prudential indicators and the insufficient resources allocated to this process. The most important cost was related to the modification of actual IT systems. The impairment methodology described by IAS 39 was rated as most challenging by preparers.

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✂ *IFRS, financial reporting, banks, accounting basis, national regulations*

INTRODUCTION

Under the EU Regulation no 1606/2002 all companies whose securities are listed on a EU regulated market were required to apply the International Financial Reporting Standards for the preparation of consolidated financial statements starting 1 January 2005. In this context, in 2005, Romanian authorities approved¹, the entities required or allowed to apply the International Financial Reporting Standards, starting the fiscal year 2006. Credit institutions were required to prepare a second set of financial statements in compliance with the International Financial Reporting Standards for other users than the State. This obligation was limited to consolidated financial statements starting 2007. After 2007 credit institutions were only allowed (but not required) to present a second set of individual financial statements in compliance with IFRS.

For 2009, 2010 and 2011, credit institutions were required again to present a second set of audited financial statements in compliance with the international financial reporting standards². During the period 2006-2011, preparation of IFRS financial statements was done by restating data prepared under national accounting regulations harmonized with European Directives. Starting 1st January, 2012, banks have the obligation to apply the International Financial Reporting Standards as basis of accounting, each transaction or event being recognized according to the requirements of IFRS³.

Thus, after six years of application of the International Financial Reporting Standards at the individual or consolidated accounts level by restating the amounts determined under Romanian regulations, credit institutions face a new challenge: the application of IFRS as accounting basis. Regulatory reforms were done and banks prepared to face the transition process.

In this context, the aim of our study is to investigate the perceptions of the main actors from banks (responsible with the transition process) on the cost and benefits involved by the use of IFRS as reporting standards and on the peculiarities related to the application of IFRS as accounting basis immediately after the transition moment. We investigated comparatively the perception of preparers towards both implementation alternatives (application IFRS by restating RAS financial statements vs. application of IFRS as accounting basis) and see if the transition process changed the attitude of banks towards the application of IFRS. IFRS application as accounting basis for the individual financial statements in the case of banks (highly regulated institutions) is challenging and research within the field is scarce. Obtaining evidence on the peculiarities of the transition process motivated our research.

A questionnaire was administrated to the persons responsible for the transition process from the banks that are part of the Romanian Banking Association in February 2012. Discussions were carried with an auditor actively involved in the transition process.

We found that preparers from banks consider beneficial the application of IFRS and agree with the proposition that the use of IFRS as a reporting standards would result in: greater access to capital, better comparability, greater reporting transparency, improved quality and timeliness of management information, harmonization and streamlining of internal and external reporting, better information for decision making, more trust of investors in the information disclosed, better understanding of credit institutions' performance and risks, reflecting economic reality in credit institutions financial statements. However, not all preparers are convinced with the proposition that the conversion will lower the cost of capital. Educational efforts are still necessary since the complex nature of IFRS, the insufficient application guidance and the necessity to adapt to frequent changes of IFRSs were considered as difficulties related to IFRS reporting. We observed that level of knowledge in IFRS in banks was negatively correlated with the index of difficulties related to IFRS application. It means that the availability of expertise within the bank influenced preparers' perception on the difficulties. Preparers acknowledged also the benefits of the use of IFRS as basis of accounting. Double reporting costs reduction and eliminating confusions by publishing two sets of financial statements were considered unanimously benefits of using IFRS as basis of accounting. It resulted that most preparers are concerned about the costs involved by the modification of internal evidence systems, the necessity to satisfy multiple reporting requirements (accounting, prudential and fiscal), the impact on prudential indicators and the insufficient resources allocated to this process.

The paper is structured as follows: the first part revises studies on IFRS application in Europe and in Romania, the second part describes the regulatory framework related to the application of IFRS in the case of Romanian banks, the third part presents the methodology used and the results obtained and the last part synthesizes the conclusions.

1. LITERATURE REVIEW

The application of IFRS in Europe was expected to determine more comparability and transparency of financial reporting (Jermakowicz & Gornik-Tomaszewski, 2006) to help outsiders to monitor managers' actions, to diminish the informational asymmetry and thus to reduce the cost of capital.

However, the studies on the effects of IFRS application at European level documented different conclusions. Daske (2006) and Jermakowicz & Gornik-Tomaszewski (2006) have found that IFRS application did not determine a reduction of the costs of capital, while Li (2010) found a significant reduction of it. Paananen & Lin (2009) found a

decrease of the quality of the accounting information published after the mandatory application of IFRS, while Armstrong *et al.* (2010) and Lenormand & Touchais (2009) found an improvement of it.

After the application of IFRS in the EU countries, Hoogendorn (2006) observed an increased volatility of the results reported which makes more difficult to assess companies' performances (Jermakowicz & Gornik-Tomaszewski, 2006; KPMG, 2007). Barth *et al.* (2008) have discovered that after the application of IFRS there is less evidence of earnings management, while Pannanen & Lin (2009) found an increase in earnings management after IFRS application in Germany.

Previous studies analyzed also the obstacles and difficulties in the application of full IFRSs (Larson & Street, 2004; Jermakowicz & Gornik-Tomaszewski, 2006), and the manner in which these standards are applied in different countries (Delvaille *et al.*, 2005). Among the obstacles reported in literature we could mention the complexity of IFRS (Larson & Street, 2004; Hoogendoorn, 2006; Gornik Tomaszewski Jermakowicz, 2006) and the insufficiency of the implementation guidance.

In the case of banks the change of the provisions calculation model proved to be a challenge related to IFRS application. Gebhardt & Novotny-Farkas (2011) examined the implications of mandatory IFRS adoption on the accounting quality of banks in twelve EU countries and concluded that the application of the incurred loss approach from IAS 39 results in a delayed recognition of future expected losses. The negative effects on regulatory requirements were investigated by Bushman & Landsman (2010) in the case of Spanish banks. The adoption of IFRS forced the Spanish banks to switch from dynamic provisioning mandated by domestic GAAP to an incurred loan-loss provisioning model prescribed by IAS 39. Bushman & Landsman (2010) pointed out that this could affect banks' ability to assess their own capital needs, and determine Spanish bank regulators to expend more resources to make their own assessment of each member bank 'risk profile.

As for the quantity of disclosure a survey conducted by KPMG (2007) including 18 of the largest European banks reporting under IFRS concluded that the size of the annual reports under IFRS has increased significantly compared to annual reports under local GAAP. A noticeable difference identified between banks was related to the treatment of provisions for loans that are assessed for impairment on an individual versus a collective basis (the percentage of collective provisions ranged from 3% to 87.8% from total provisions). The information about the classification between individually significant and not individually significant loans tended to be generic in nature.

Dunne *et al.* (2008) investigated IFRS implementation in UK, Ireland and Italy and pointed that an important issue identified in all three countries was related to staff training and adapting to rapid changes. Certain standards were considered very technical and required the assimilation of specific skills (such as IAS 39, IAS 19 and IAS 36). Entities engaged often external consultants to provide the necessary

knowledge. In the case of banks, major changes were required to information systems, different processes and operating models being introduced. The preparers from banks informed that they had to make a lot of operational changes to implement the new reporting rules. One of the main problems raised was related to the implementation in detail of certain standards that become completely immaterial once implemented (such as the use of the effective interest method for loans). IAS 39 determined important system changes due to the hedging and impairment evaluation requirements. Interviewees agreed that the benefits of transparency, comparability and uniformity would materialize in the medium to long term. Italian interviewees agreed that IFRS reporting would permit and improved analysis on entities performance while their English or Irish colleagues were more skeptical on the issue.

Few empirical and qualitative studies examined various aspects of IFRS implementation in Romania. Ionașcu *et al.* (2011) investigated the perception of the CFOs of the Romanian listed companies on the effects of IFRS implementation and the institutional factors that might influence them, while Albu *et al.* (2011) explored the views of major actors involved in financial reporting (users, professional accountants, auditors and the standard setter) on IFRS application. Bunea *et al.* (2011) investigated the opinions of the accounting professionals in Romania related to a potential application of IFRS for SMEs. Other studies analyzed the influence of IFRS application on the cost of capital (Ionașcu *et al.*, 2010; Munteanu *et al.*, 2011). Few studies conducted by KPMG Romania (2010 and 2011) focused on the application of IFRS in the banking sector. They reviewed the differences between the requirements of the national accounting regulations applicable to credit institutions and those of the International Financial Reporting Standards and measured their impact on banks equity and income. Also, in the context of IFRS use as accounting basis starting 1st January 2012, Ștefan & Mușat (2011) analyzed the regulations issued by the National Bank, Grecu (2011) reviewed the challenges of IFRS implementation in Romanian banks from the perspective of managers and auditors, while Răducănescu & Dima (2011) analyzed the impact of IFRS application on prudential regulations.

2. THE REGULATORY FRAMEWORK RELATED TO THE APPLICATION OF IFRS IN ROMANIAN BANKS

Starting 2007 IFRSs became mandatory for consolidated financial statements of listed entities along with an application of the national regulations for the preparation of individual financial statements. The provision of the Order of the Ministry of Finance no 907/2005 requiring banks to prepare a set of consolidated financial statements in accordance with IFRS for 2006 has been confirmed by the Order of the Ministry of Finance no 1.121/2006 for subsequent periods. In addition, the Order of the Ministry of Finance no 1.121/2006 also established EU *endorsed* IFRS as mandatory accounting standards for consolidated financial statements of listed companies starting 2007. Public-interest entities, other than banks and listed companies, could prepare their consolidated financial statements in accordance with either *endorsed* IFRS or

national accounting regulations compliant with the Seventh Company Law Directive. Public interest entities were allowed to prepare a second set of individual financial statements under IFRS for specific informational needs.

Consequently, under this option, certain banks (generally subsidiaries of foreign banks) used to draw up two sets of financial statements, the first one in compliance with national regulations and the second under IFRS. In the context of the financial crisis the differences between banks' profits under IFRS and the profits determined after the Romanian regulations increased significantly. This happened mainly because of the discrepancy between the figures reported for loan impairment provisions under IFRS and those calculated under, more prudent, Romanian regulations. According to the regulations issued by the National Bank, loans granted by banks are classified as standard, watch, substandard, doubtful and loss based on the financial performance and on the debt service of the borrower. For the first four categories, the necessary provision is calculated by applying a rate to the outstanding loan balance and related accrued interest after deducting the fair value of any collateral obtained by the bank from its borrowers. This is different from the impairment procedure described by IAS 39 for financial assets. The differences in impairment expenses affected the results determined, some banks reporting losses under national regulations and profits under IFRS. This situation determined investors to require the use of IFRS.

Following the recommendations received from the World Bank and the International Monetary Fund⁴ and banks requirements, the National Bank issued the Order no 9/2010 stating that EU endorsed IFRS will be have to be applied for the preparation of the individual financial statements of credit institutions and for the recording of transactions starting 2012. In order to inform regulators during the transition period, credit institutions were required to prepare a second set of individual financial statements for 2009, 2010 and 2011 under endorsed IFRS. Ștefan and Mușat⁵ (2011) explain that this compromise solution was necessary because of the heterogeneity of credit institutions preparedness to apply immediately IFRS (some banks were very experienced as they reported for many years in compliance with IFRS while other banks had to apply IFRS for the first time). The Ministry of Finance required data on the impact of IFRS application on fiscal profit as new fiscal regulations had to be issued.

After 1 January 2012 certain regulatory changes were necessary in order clarify the impact of the change on prudential indicators and the calculation of the fiscal profit (now determined by adjusting an accounting profit under IFRS). The National Bank of Romania issued the Order no 27/2010 containing accounting regulations in conformity with IFRS. It includes rules related to the approval, auditing and filling of financial statements, the chart of accounts, prescriptions related to primary documents and registers used and additional disclosure requirements but it does not prescribe a standardized format of financial statements or other recognition, valuation and classification rules different from those prescribed by IFRSs.

A revision of the existing provisions of the Romanian Fiscal Code was realized and specific tax provisions applicable both at the time of the conversion to IFRS as well as for subsequent periods were introduced starting 1 January 2012. According to the Emergence Governmental Ordinance no 125/2011 at the time of IFRS transition the amount of the specific credit risk provisions that exceeds the level of the adjustments calculated according to IFRS (the difference being recorded on the credit side of the retained earnings) will not be taxable on the date of the IFRS conversion, but treated as a reserve which will become taxable upon the reduction or the cancellation of the reserve. If the level of the provisions calculated according to IFRS exceeds the level of the specific credit risk provisions, the difference recorded on the debit side of the retained earnings account is deducted in equal installments, over a period of 3 years.

For depreciable fixed assets and land for which the accounting policy changes from the revaluation model to the cost model, revaluations performed according to the accounting regulations must be deducted from the fiscal value but inflation adjustments must be included⁶. The amounts recorded on the credit side of the retained earnings account resulting from inflation adjustments in respect of such assets are not be taxable at the time of the conversion, but treated as reserves which will become taxable upon reduction or cancellation.

For other balance sheet items for which the accounting policy changes from the revaluation model to the cost model, inflation adjustments should not be included. Amounts recorded in retained earnings as a result of the IFRS conversion from other adjustments will be treated following the general principles: the elements assimilated to income will be taxable and elements assimilated to expenses will be deductible. The tax treatment of the amounts representing reversal of an element of income/expenses previously recorded depends on the tax treatment applied in the past for the reversed element. Credit institutions can deduct the provisions calculated according to the IFRS principles and prudential filters established by the National Bank of Romania. The prudential filters represent positive differences between the prudential value adjustments calculated according to the methodologies applicable starting with 2012 and the adjustments for depreciation calculated according to IFRS provisions. For the assets classified as investment property, the fiscal impact is similar to that applicable to tangible assets. Therefore, for property investment, income derived from changes in fair value as a result of applying the fair value model is considered non-taxable income. This income will be taxable upon deduction of the fiscal depreciation and removal of such investment property from the books. All these provisions aimed not to affect too much the banks by the switch to IFRS.

The prudential aspects affected by IFRS were those related to provisions (as provisions are recorded in accounting according to IFRS measurements), solvability, currency positions and own funds. New prudential filters were introduced to avoid the impact of IFRS application on the solvability of Romanian banks. Before 1 January 2012 IFRS financial statements were obtained by restating financial statements in compliance with Romanian regulations. The restatements were done by a limited number of specialists only for reporting purposes and didn't affect the evidence

systems. The use of IFRS as basis of accounting involves the application of IFRSs when each transaction is recognized. Consequently existing IT systems need to be adjusted for the implementation of new calculation and reporting functions in the existent solutions (such as calculation of the effective interest rate and of provisions). New accounting personnel must have knowledge in IFRS. IFRS disclosure requirements might involve the modification of source systems and the development of interfaces with IFRS applications lead to increased volatility in financial results, as compared to results that would have been reported under national standards, for reasons such as the recognition of more financial assets and liabilities (including derivatives) at fair value, tougher rules on the requirement to record special-purpose vehicles or similar structures on balance sheet, more rigorous asset impairment reviews. Consequently, net income and net assets, key inputs in financial ratios assessing performance, could look significantly different under IFRS.

The impact of IFRS application as basis of accounting on banks is expected to be more significant. Because there is no empirical evidence on the perceptions of preparers from banks on each IFRS application strategy we conducted an exploratory study to gain insight into the process of applying IFRS for Romanian banks.

3. RESEARCH METHODOLOGY AND RESULTS

3.1. Research methodology

To achieve our objective, we developed a questionnaire in order to gather information about the perception of preparers on the costs, difficulties encountered and potential benefits to be gained. Because the Romanian banks were using IFRS as a reporting standards before 1st January 2012, being required to fill audited IFRS financial statements to the National Bank, we included separate questions on the costs and benefits for each IFRS application alternative to see if there is any change in preparers' perception. This paper is based on the results of this survey. We asked a Big Four auditor involved in auditing banks IFRS financial statements and a member of the accounting working group of the Romanian Banking Association to comment on the instrument before it was administered. We adjusted the questionnaire according to commentaries received and sent it to project managers responsible for the implementation of IFRS in banks members of the Romanian Banking Association (40 banks from 42 acting in Romania in 2011). Our contact with respondents was facilitated by the Romanian Banking Association as the respondents were participating to the accounting working group of the Association. Responses were received by e-mail. The names of banks and the identity of respondents will not be disclosed according to a confidentiality policy communicated in advance to respondents. Discussions were carried with a Big Four auditor in order to gain a deeper understanding of the process.

The questionnaire included questions related to respondents' profile (professional experience and experience in IFRS), questions on the application of IFRS in the credit

institution, questions on the benefits and costs of IFRS use as reporting system and questions on the use of IFRS as basis of accounting. We asked also respondents to rate certain IFRS accounting treatments according to their difficulty (we developed the list based on results of prior studies). Two open ended questions were addressed regarding the impact of the transition process on IT systems (changes occurred) and on the difficulties encountered in applying new fiscal regulations. We avoided asking questions on the bank or bank's operations because we considered that we risk discouraging respondents to answer. The possible benefits and costs included as alternative answers were developed based on prior literature and public debates preceding the IFRS transition process.

3.2. Results

Following our study, we observed a positive attitude toward IFRS application, all respondents declaring that IFRS reporting would be necessary even if it wouldn't be required by the Romanian law and that they consider the cost benefit report related to IFRS application as basis of accounting positive.

Also, we asked respondents about the benefits of using IFRS as reporting standards. The answers were measured on a five-point Likert scale from strongly disagree (1) to strongly agree (5). In Table 1, we present the mean, standard deviation, minimum, maximum and mode (most frequent answer) for each of the 11 expected benefits (identified based on literature review). The higher the score, the more the respondents agreed with the statement; the lower the score, the more the respondents disagreed with the statement.

Table 1. Perceptions of preparers regarding the benefits of IFRS application as a reporting system

	Mean	Mode	Std. Dev.	Minimum	Maximum
Greater access to capital	4.2	4	0.632	3	5
Lower cost of capital	3	2 and 4	1.247	1	5
Increased cross-border listings	3.4	4	1.35	1	5
Better comparability	4.8	5	0.422	4	5
Greater reporting transparency	4.6	5	0.516	4	5
Improved quality and timeliness of management information	4.5	4, 5	0.527	4	5
Harmonization and streamlining of internal and external reporting	4.5	5	0.707	3	5
Better information for decision making	4.5	5	0.707	3	5
More trust of investors in the information disclosed	4.4	4	0.516	4	5

	Mean	Mode	Std. Dev.	Minimum	Maximum
Better understanding of credit institutions' performance and risks	4.2	4	0.422	4	5
Reflecting economic reality in credit institutions financial statements	4.4	5	0.699	3	5

Values used: Strongly Agree—5; Agree—4; Undecided—3; Disagree—2; Strongly Disagree—1.

As for the benefits of IFRS reporting, on average the respondents agreed with the proposition that the use of IFRS as a reporting system would result in: (1) greater access to capital (mean response 4.2; mode 4), (2) better comparability (mean response 4.8; mode 5), (3) greater reporting transparency (mean response 4.6; mode 5), (4) improved quality and timeliness of management information (mean response 4.5; mode 4, 5), (5) harmonization and streamlining of internal and external reporting (mean response 4.5; mode 5), (6) better information for decision making (mean response 4.5; mode 5), (7) more trust of investors in the information disclosed (mean response 4.4; mode 4), (8) better understanding of credit institutions' performance and risks (mean response 4.2; mode 4), (9) reflecting economic reality in credit institutions financial statements (mean response 4.4; mode 5).

Disagreement was expressed by some preparers in identifying increased cross-border listings as a benefit of IFRS reporting. Other disagreed with the proposition that the conversion will lower the cost of capital which indicates that some preparers do not perceive the quality of the reporting system as influencing the cost of capital. Promoters of IFRS application advance the idea that adopting IFRS will increase the quality of financial reporting which will diminish the informational asymmetry and the risk and consequently will decrease the cost of capital. However, research studies reveal contradictory results on this hypothesis (Armstrong *et al.*, 2010; Li, 2010; Daske, 2006).

We also asked respondents about major challenges of IFRS application. The answers were measured on a five-point Likert scale from strongly disagree (1) to strongly agree (5). In Table 2, we present the mean, standard deviation, minimum, maximum and mode (most frequent answer) for each application difficulty.

Table 2. Major challenges to use IFRS as reporting system as listed by respondents

	Mean	Mode	Std. Dev.	Minimum	Maximum
Complex nature of IFRS	3.5	4	1.08	2	5
Insufficient application guidance	3.1	4	1.449	1	5
Insufficient expertise in IFRS within the credit institution	2.9	2	1.287	1	5
Adapting to frequent changes of IFRSs	3.1	4	0.994	2	4

Values used: Strongly Agree—5; Agree—4; Undecided—3; Disagree—2; Strongly Disagree—1.

The complex nature of IFRS, the insufficient application guidance and the necessity to adapt to frequent changes of IFRSs were considered as difficulties related to IFRS reporting. We considered that these difficulties are easier to overcome through education, so we applied a Spearman Rank Correlation test for the index summarizing grades granted by respondents to difficulties and the grade given by respondents for the level of knowledge in IFRS in their bank (between 1 and 5) identifying a negative correlation between the two indicators ($p = 0.025 < 0.05$).

We also asked respondents to grade how relevant are IFRS financial statements for certain users. The answers were measured on a three-point Likert scale from irrelevant (1) to very relevant (3). In Table 3, we present the mean, standard deviation, minimum, maximum and mode (most frequent answer) for each of the 7 potential users identified. Respondents expressed unanimously that IFRS financial statements are very relevant for current and potential investors, managers and financing corresponding banks and relevant to a lower extent for supervising authority, fiscal authority and banks' clients.

Table 3. Relevance of IFRS financial statements for users

	Mean	Mode	Std. Dev.	Minimum	Maximum
Current Shareholders	3	3	0	3	3
Managements	3	3	0	3	3
Potential investors	3	3	0	3	3
Supervising authority	2.8	3	0.422	2	3
Fiscal authority	2.4	2	0.516	2	3
Banks 'clients	2.4	3	0.699	1	3
Financing corresponding banks	3	3	0	3	3

Values used: very relevant—3; relevant—2; irrelevant—1.

The application of IFRSs as basis of accounting was included in the MOU between the Romanian government and the International Monetary Fund. According to Ștefan and Mușat (2011), the decision is seen as beneficial because it will avoid future confusions related to the publication of two sets of accounts, it will eliminate restatement costs (as IFRS financial statements are obtained directly) and it will permit the comparison of information included in consolidated financial currently in compliance with IFRS with data from individual financial statements facilitating the consistency in supervision at both levels. We asked preparers from banks if they share the opinion of the regulator related to the benefits of IFRS application as basis of accounting. Answers are synthesized in Table 4.

Table 4. Benefits of IFRS application as basis of accounting

	Mean	Mode	Std. Dev.	Minimum	Maximum
Consistency in supervision on individual basis vs. on consolidated basis	3.5	4 and 5	1.509	1	5
Eliminating users confusions by publishing two sets of financial statements	4.7	5	0.483	4	5
Cost reduction (by avoiding the preparation of two sets of financial statements RAS and IFRS)	4.1	4	0.738	3	5

Values used: Strongly Agree—5; Agree—4; Undecided—3; Disagree—2; Strongly Disagree—1.

Respondents perceive the benefits of the use of IFRS as basis of accounting. Double reporting costs reduction and eliminating confusions by publishing two sets of financial statements were considered unanimously benefits using IFRS as basis of accounting.

Regarding the use of IFRS as basis of accounting we asked our respondents to grade main difficulties and costs supported. Answers are presented in table 5.

Table 5. Difficulties and costs related to the use of IFRS as basis of accounting

	Mean	Mode	Std. Dev.	Minimum	Maximum
Managing the volatility of earnings and owners' equity	2.9	2	1.101	2	5
Satisfying multiple reporting requirements (accounting, prudential, fiscal)	3.7	5	1.494	1	5
Costs involved by the modification of internal evidence systems	4.4	4	0.516	4	5
Fiscal costs of transition to IFRS	2.8	2	1.135	2	5
Impact of IFRS application on prudential indicators	3.5	4	1.179	2	5
Insufficient resources dedicated to IFRS transition process	3.3	4	1.418	1	5

Values used: Strongly Agree—5; Agree—4; Undecided—3; Disagree—2; Strongly Disagree—1.

It resulted that most respondents are concerned about the costs involved by the modification of internal evidence systems, the necessity to satisfy multiple reporting requirements (accounting, prudential and fiscal), the impact on prudential indicators and the insufficient resources allocated to this process. Only certain banks are concerned about the volatility of earnings and owners' equity and the fiscal costs of the transition to IFRS.

Regarding the financial dimension of the costs involved respondents rated among first three most important costs related to the conversion to IFRS respondents identified the costs related to adapting the IT systems to IFRS requirements, consultancy costs, personnel training and fiscal costs. The costs related by the modification of IT systems were rated by most preparers as being the most significant. According to Grecu (2011) decisions about IT systems and the support processes on a timely basis could control the costs and the unnecessary risks that occur as a consequence of possible doubled effort or of changes in approach at a later stage. He argues that in some cases many “temporary” solutions identified at the moment of the conversion to IFRS remain in force for many years, even after the conversion process ends, even though this may require a large amount of work, and a detailed analysis proves their inefficiency in terms of cost.

Before 1st January 2012 banks applied the National Bank of Romania (BNR) Governor’s Order 13/2008 (which on 1 January 2009 replaced BNR Governor’s Order 5/2005 with subsequent amendments). This regulatory framework stipulated basic accounting principles and requirements for bookkeeping. The fiscal profit and prudential indicators were based on Romanian regulations. Main differences between Romanian regulations and IFRS that affected the financial statements of banks identified by KPMG (2011) study refer to: impairment of loans and advances to customers adjustments, amortized cost adjustments, deferred tax related adjustments, fair value of financial instruments, other adjustments related to the impairment of land and buildings, employee benefits, leases, amortized cost of financial liabilities, restatement adjustments required in accordance with IAS 29 (from the period when Romania had hyperinflation), functional currency related adjustments. According to KPMG study (2011) at the end of 2010, the differences in total profit or total equity between IFRS and Romanian GAAP continued the ascending trend, observed in the previous periods, mainly through impairment provisions for deteriorating quality of loan portfolios (the adjustment referring to the impairment of loans and advances to customers had a higher than 5% impact on profit and a higher than 5% impact on equity for the majority of the banks included in the study.). The results of the survey showed that in 2010, and continuing in the first half of 2011, the impairment provision adjustments had a high negative impact both on the statutory profit and loss account and equity mainly due to the continued deterioration of the collaterals and the client creditworthiness. Another factor significantly influencing the statutory results was the increase in the contract early cancellation and the impairment of the recovered collateral. According to National Bank data Romanian banks have unlocked loan loss provisions worth around 10 billion lei (EUR 2.3 billion) following the adoption of the international financial reporting standards in January 2012.

Regarding new accounting treatments that respondents consider the most difficult to apply we identified the following issues considered by respondents in the first three most difficult treatments affecting their bank: the impairment methodology in compliance with IAS 39, valuation at fair value of financial instruments, deferred tax,

hedge accounting, and the disclosure requirements of IFRS 7. The impairment methodology was rated by most banks as being among first three most difficult treatments affecting their bank. This is caused by the fact that the provisioning methodology specified in IAS 39 is not normative, in opposition to the existing specifications of the National Bank of Romania. It emphasizes professional judgment which is crucial in estimating many factors used in provisions calculation. As such, the banks need to develop not only the methodologies which are in accordance with IFRS general principles, but also systems for provisions ratification (back testing, stress-testing, etc.) able to reduce or correct the element of subjectivity (KMPG, 2011).

Another difficulty related to the application of IFRS as accounting bases was related to calculation of the income tax. The taxable profit is determined by adjusting the accounting profit considering the provisions of the Fiscal Code, which details the deductible expenses and taxable income. Literature agrees on three aspects of IFRSs that make controversial their concrete application: the balance sheet approach, the use of fair value accounting and the substance over form principle (Schön, 2004; Eberhartinger & Klostermann, 2007). The fiscal provisions require to a lower extent the use of fair value as tax basis. The Fiscal Code is still silent on the acceptability of the substance of form principle. From the discussions that we had with the auditor it resulted that banks generally follow substance over form for accounting purposes and the legal form of transactions to determine the fiscal treatment. Another issue reported by the auditor was related to lack of fiscal prescriptions regarding materiality when embedded financial instruments are separated. The determination of deferred tax on 1 January 2012 represented a challenge for certain preparers which implies that educational efforts are still necessary. Respondents raised concerns regarding the lack of prescriptions on the documentation necessary to the determination of tax on buildings (as after the revision of the Fiscal Code banks are permitted to determine the tax base of buildings at revalued amounts even if they use the cost model in accounting) and the documentation required for the tax bases on 1st January 2012, the fiscal impact of certain adjustments at the transition to IFRS and the fiscal treatment of the impairment of available for sale financial assets. The auditor informed us that banks followed generally a prudent approach in determining tax basis of assets and liabilities.

CONCLUSIONS, LIMITS OF THE RESEARCH AND FUTURE RESEARCH DIRECTIONS

According to this study preparers from Romanian banks have a positive attitude related to the application of IFRS considering the cost benefit report as a positive one. This is explained by the fact that most Romanian banks are financed by foreign capital and would publish voluntarily IFRS financial statements for foreign shareholders. Preparers agreed with the proposition that the use of IFRS as a reporting standards

would result in: greater access to capital, better comparability, greater reporting transparency, improved quality and timeliness of management information, harmonization and streamlining of internal and external reporting, better information for decision making, more trust of investors in the information disclosed, better understanding of credit institutions' performance and risks, reflecting economic reality in credit institutions financial statements. However, not all preparers were convinced with the proposition that the conversion will lower the cost of capital. Educational efforts are still necessary since the difficulties related to the application of IFRS are negatively correlated with the level of knowledge of personnel in IFRS. Preparers considered that double reporting costs reduction and eliminating confusions by publishing two sets of financial statements are benefits of using IFRS as basis of accounting. It resulted that most preparers are concerned about the costs involved by the modification of internal evidence systems, the necessity to satisfy multiple reporting requirements (accounting, prudential and fiscal), the impact on prudential indicators and the insufficient resources allocated to this process. The most important cost was related to the modification of actual IT systems. The impairment methodology described by IAS 39 was rated as most challenging by preparers. The respondents also considered that the new prescriptions included in the Fiscal Code are not sufficient to clarify the tax impact of all IFRS treatments.

The limits of the research are related to the subjectivity involved by the methodology used (based on questionnaires), the representativeness of the opinions expressed by banks representatives responsible for IFRS transition process for the general opinion shared by preparers involved in IFRS application in their banks and the fact that the study didn't include all Romanian banks.

In order to gain a deeper understanding of the transition process future research could aim interviewing other actors from banks and external actors (auditors, regulators) involved in the transition process and questionnaires based on a statistical representative sample of preparers from banks.

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- ¹ The Order of the Ministry of Finance no. 907/2005 regarding the approval of the entities required to apply the accounting regulations based on IFRSs, or accounting regulations in conformity with the European Directives respectively.
- ² The Order of the National Bank of Romania no. 15/2009 regarding the presentation of individual financial statements in compliance with IFRS for informative purposes.
- ³ The Order of the National Bank of Romania. No 9/2010 regarding the application of the International Financial Reporting standards as basis of accounting for the individual financial statements starting 2012.
- ⁴ The application of IFRSs as basis of accounting was included in the MOU between the Romanian government and the International Monetary Fund.
- ⁵ Experts of the Regulation and Authorisation Direction within the National Bank of Romania.
- ⁶ Some banks that were using the revaluation model under RAS (to benefit certain fiscal incentives) changed their accounting policy under IFRS (to the cost model), because their parent banks were reporting under GAAPs prohibiting the revaluation model and were using the cost model under IFRS.