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The progress of ideas

IFRS ADOPTION IN ROMANIA AND THE IMPORTANCE OF AUDITOR SIZE

Abstract: *The recent accounting regulations in Romania have made mandatory the use of IFRS in the individual financial statements of the companies listed on stock exchange. The aim of this study is to see to what extent the figures in the statements have been influenced by this new enforcement. We have studied the companies affected by this regulation and publicly traded on the Bucharest Stock Exchange. Our findings showed that, on average, Romanian companies did not comply with IFRS practices, as they prefer the practices that do not differ from national regulation. Moreover, the study has shown that the companies audited by a Big 4 have adopted practices closer to the Anglo Saxon accounting system.*

Key words: *IFRS implementation, individual statements, Romania, auditor.*

1. Introduction

Romania has adhered to the European Union in 2007. As a member state, it had to apply its accounting Directives and Regulations. According to Nobes' accounting systems classification [1998], Romania exhibits the characteristics of the class B system, i.e. the continental European system. Romanian accounting harmonisation has been realised in many stages over time. One of the latest laws (but not least) considering this subject was the Order of the Ministry of Finance (OMFP) nr. 1286/2012. According to this OMFP, Romanian companies traded on stock exchange are obliged to use International Financial Reporting Standards (IFRS) when completing their individual financial accounts. They have to implement IFRS from 2013 onwards.

2. The effect of IFRS application in Romania

We can find a big amount of studies concerning the effect of IFRS adoption. For instance, Jermakowicz [2004] has analyzed the process of IFRS adoption in

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An. Inst. Cerc. Ec. „Gh. Zane", t. 25, Iaşi, 2016, p. 3–9

Belgium. This country has also a continental European accounting system, just like Romania's one. She has analyzed three companies that had implemented IFRS for the first time in 2003. The author of the study concluded that efforts undertaken by companies to adopt IFRS in accounting practices have been translated into a significant impact on reported net earnings values.

Jermakowicz and Gornik-Tomaszewski [2006] have analyzed the process of IFRS adoption at the European Union level and concluded that many companies have adopted these standards even before the 2002 Regulation has been issued. The questionnaires' answers have revealed the fact that the majority of respondents have adopted IFRS not just for consolidated financial statements, but still, they would have not been implemented them if they were not required by law. Moreover, the process is burdensome and costly and the companies are not expecting to cut the price of equity.

Weiβenberger, Stahl and Vorstius [2004] have analyzed the reasons why German companies preferred IFRS to the detriment of German GAAP (Generally Accepted Accounting Practices). Among the reasons we can find: the gaining of a higher status on financial markets, the internationalization of investors, and the creation of important supplementary information. However, after the actual implementation of IFRS, companies have reported that none of the above was met.

Niskanen, Kasanen and Kinnunen [2000] considered that financial reporting under IFRS in Finland has not made a significant difference for the 18 companies studied in the period 1984–1992, so the data reported by these companies is not radically different.

So can be said about Spain, as concluded by Callao et al. [2010]. The authors did not find a significant improvement in financial statements. Carini et al. [2011] state that Italian companies are reluctant to the application of IFRS, because they have to recalculate the taxes. Istrate [2014] studied the effect of IFRS on reported net earnings of Romanian companies showing a negative effect of IFRS implementation. Daske et al. [2013] admit that many companies apparently adopt IFRS, but, in fact, this does not produce major changes in accounting practices.

In addition to studying the impact of transition to IFRS on accounting figures, it is useful to assess auditor's influence on these figures.

DeAngelo [1981] and Watts and Zimmerman [1986] suggest that large audit firms provide audit service of superior quality compared to small audit firms, as they are more independent. Caramnis and Lennox [2008] analyzed Greece's example and concluded that the Big 5 firms spend more time on audit action compared to other firms. Moreover, they found a direct correlation between the time spent on auditing and earnings' management. Thus, companies audited by non-Big 5 firms have evidence of result's manipulation. Tsalavoutas and Evans [2010] have studied the impact of IFRS on Greek companies and found significant differences in the case of companies audited by the Big 4 compared to those audited by non-Big 4 firms.

Ionaşcu et al. [2014] and Munteanu [2011] state that in Romania accounting practitioners are open and optimistic regarding the application of IFRS, being aware of their benefits. In order to study the impact of IFRS enforcement on individual financial statements, we have studied the entities listed on the stock exchange, taking into account the changes in equity after IFRS application and studying the impact of auditor's size on these figures.

3. Methodology

In order to study the impact of IFRS implementation in Romania, we have used Gray's index. In 1980 Gray proposed a "conservatism" index, which measured the impact of new accounting standards. The index has the following formula:

$$I_C = 1 - \frac{R_A - R_P}{|R_A|}$$

Where I_C is the conservatism index, R_A is the *adjusted result on IFRS,* R_P is the *published result according to national standards.*

This index measures the differences between the result calculated according to national accounting standards and the result calculated according to IFRS. The values obtained by the index can be explained as follows:

- If $I_C > 0$ than we can state that the companies have adopted accounting practices different from the national ones;
- An index $I_C < 0$ shows the conservatism of the companies, as a proof that the companies prefer the practices that do not differ from the national ones.

Gray suggests that an index superior to 1.50 is characteristic to the very optimistic companies, and an index inferior to 0.50 is for the very conservative companies. Other three subgroups can be identified:

- The pessimistic subgroup, where $I_C < 0.95$;
- The optimistic subgroup, where $I_C > 1.05$;
- The neutral subgroup, where I_C takes values between 0.95 and 1.05.

In order to appreciate the effect of IFRS adoption on equity, we have used the data from 2011 financial statements, where we could gather also information regarding companies' auditor.

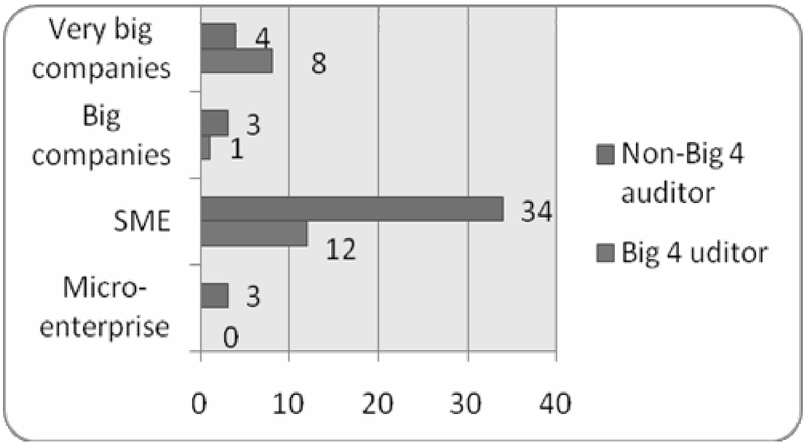
In our study we have used the following formula:

$$I_C = 1 - \frac{E_{IFRS} - E_{RAS}}{|E_{RAS}|}$$

where E_{IFRS} is the equity calculated according to IFRS regulation, and E_{RAS} is the equity calculated according to Romanian regulation. We have used this formula as the scope of this study is to compare IFRS figures with those completed according to national rules. This formula was also used by Haller et al. [2009], Hellman [2011], and Istrate [2014].

The data was gathered from the Bucharest Stock Exchange site, namely www.bvb.ro. Starting from the total number of listed companies (83), we have excluded from the study financial intermediaries (as they are the subject of different regulations), unlisted companies, firms with the financial year different from the fiscal one, and companies for which it was impossible to gather data for 2011. In the end, we had a sample consisted of 65 companies.

When referring to companies' auditors (figure 1), we can observe that the majority of them have opted for a non-Big 4 auditor. This comes naturally if we think about the price asked by Big 4 auditors for their services. Many companies cannot afford to pay such a big amount of money. We can see that only the majority of the very big companies' category has opted for a Big 4 auditor operating in Romania, such as KPMG, Deloitte, PricewaterhouseCoopers or Ernst & Young.



Source: Authors' representation.

Figure 1. Companies' auditors.

When studying the importance of the auditor in IFRS transition, we used **Stata** software to realize the regression analysis of Gray's index on equity.

4. Results and discussions

In what follows, we present the results of the index and its regression based on the type of auditor (Big 4 *versus* non-Big 4).

Table 1

Gray's index on equity

Gray's index		*Ic* = 1.05
Gray's index, classified by subgroups		**Number of companies**
I	0.5	1
II	0.5–0.74	2
III	0.75–0.94	6
Pessimistic (<0.95)		*9 (14%)*
IV	0.95–0.99	7
V	1	18
VI	1.01–1.05	13
Neutral (0.95–1.05)		*38 (58%)*
VII	1.06–1.25	12
VIII	1.26–1.5	2
IX	1.5	4
Optimistic (> 1.05)		*18 (28%)*
Total		**65 (100%)**

Source: Authors' calculations.

As we can see in the table 1, Gray's general index takes the value 1.05. This proves that on average Romanian companies that applied for the first time IFRS in individual financial statements have been *neutral* in what concerns the application of IFRS. This means that the firms were reluctant in applying different accounting practices than the national ones. 14% of the companies were *pessimistic*, and other 18% were optimistic in applying IFRS. The majority of the companies (58%) were *neutral*, so they applied the same accounting practices be it before or after IFRS implementation. We can find one very pessimistic company, with an index below 0.5 and four very optimistic companies, with an index above 1.5.

We have also realized index's regression on auditor's type. The results are presented as follows.

Table 2

Results of the regression

Source	SS	df	MS		
				Number of obs =	**65**
Model	**.210726796**	**1**	**.210726796**	F (1, 63) =	**2.38**
Residual	**5.57061144**	**63**	**.088422404**	Prob > F =	**0.100**
Total	**5.78133824**	**64**	**.09033341**	R-squared =	**0.0364**
				Adj R-squared =	**0.0212**
				Root MSE =	**.29736**

ic	Coef.	Std. Err.	t	P>|t|	[95 % Conf.	Interval]
auditor1	**.1217533**	**.0788682**	**1.54**	**0.100**	**-.2793587**	**.0358522**
auditor2	**0**	(omitted)				
_cons	**1.093182**	**.0448286**	**24.39**	**0.000**	**1.003599**	**1.182765**

The results (significant at 10%) reveal a direct and positive relationship between index's values and the auditor type. In this way, the companies with a Big 4 auditor have an index 0.12 points higher compared to the companies with other auditors. The absolute value is not so big, but if we consider the possible values of the index, the findings make sense and are relevant for the study of IFRS impact on Romanian companies' financial statements.

5. Conclusions

The study proves that Romanian companies are on average neutral in what concerns the application of IFRS. They have chosen not to apply different accounting practices from the national regulations. This can be explained by the strong relationship between accounting and fiscality, as the practitioners do not want to retreat financial statements for state's use. Another cause of these poor results is the weak Romanian accounting profession. Moreover, many companies do not held the financial resources in order to train accounting professionals in the IFRS spirit.

Another finding of the study is that companies with an auditor from the Big 4 group have a higher index. This group of auditors has a big expertise in applying IFRS, as they are present worldwide. It must be also stated that the auditor often offers consultancy for the client on IFRS matters.

The flexibility of IFRS has leaded the majority of Romanian companies to adopt practices that do not differ from the national regulation. Still, Romania has undertaken important steps towards accounting convergence and this cannot be neglected, as it represents an important step towards international accounting approach.

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