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The effects of IFRS on net income and equity: evidence from Romanian listed companies

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Abstract

IFRS adoption in Europe represents a major milestone towards financial convergence and Romania, as European member state, had in the last few years a positive reaction towards this process. Starting with year 2012, Romania imposed through its national regulatory body (the Ministry of Finance) the presentation of individual financial statements according to IFRS for 67 Romanian listed companies. The main concern has been to understand the most important differences between national accounting rules and IFRS and how these could affect their reported performance. The goal of the paper is to address this concern by highlighting some empirical evidence of the differences between Romanian accounting regulation and IFRS. These differences are identified in the reconciliation of shareholders’ equity and net income of the Romanian listed companies in order to present the significant impacts of the conversion to IFRS. The conclusion of this study is that for all 67 companies, presented in our study, the application of IFRS had a small effect on net income and shareholders’ equity.

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1. Introduction

The transition to IFRS represents a complex technical construction. Financial resources, economic resources as well human resources are necessary in order to face the multiple changes that this process requires. IFRS are being used worldwide by over 120 countries and reporting jurisdictions that either require or allow its use for the preparation of financial statements for publicly-held companies. Growing interest in the global acceptance of a single set of accounting standards comes from all participants in the capital markets. Their adoption represents an important element to obtain a competitive European market. Enormous literature concerning the process of international accounting harmonization and convergence is available. The role of International Accounting Standards Board (IASB) is presented in order to have the complete image of the process.

The adoption of IFRS as issued by the International Accounting Standards Board (IASB) would determine an application of a common set of financial reporting standards. Every jurisdiction is different and will therefore follow its own path towards achieving the objectives related to IFRS adoption. It is a matter of adopt or converge? While convergence may be the necessary preparation for some countries to adopt IFRS, the simplest, least costly and most straightforward approach is to adopt the complete body of IFRSs in a single step. The main reason why most companies want to use IFRSs in their financial statements is the ability to demonstrate to the investor community that their financial statements are IFRS compliant and there for could be more reliable.

Beginning from the year 2007, Romanian listed companies, financial institutions prepare their consolidated
financial statements in accordance with IFRS. It was a compulsory process for adoption of IFRS. The application of IFRS has been extended in 2012 to the individual financial statements of 67 listed companies. The goal of the paper is to provide some empirical evidence of the differences between Romanian accounting regulation and IFRS, by analyzing the total adjustments to IFRS in the reconciliation of shareholders equity and net income of Romanian listed companies. The level of discrepancy between Romanian accounting regulation and IFRS is measured by using the proposed proportionality index (Cordazzo, 2008).

2. Research methodology

The effects of IFRS transition for entities was investigated among others by Mazars (2005), KPMG International and Goldman Sachs (2002), O’Connell and Sullivan (2008), Cordazzo (2008), Christensen et al. (2007), Beckman, Brandes and Eierle (2007), Jermakowicz and Gornik - Tomaszewski (2006), Larson and Street (2004a and 2004b), Jermakowicz (2004), Pascan and Turcas (2012), Kubičkova and Jindrikovska, (2012).

Following the findings of the named studies the goal of this paper is to present empirical evidence of the size and nature of the differences between Romanian accounting regulation and IFRS, by analyzing the total adjustments to IFRS in the reconciliation of shareholders’ equity and net income presented by Romanian listed companies in the individual financial statements. The indexes proposed by Cordazzo (2008) were used by us in order to analyze the quantitative effect of the principal impacts emerging from the application of IFRS compared to Romanian accounting regulation.

Following Gray’s methodology this study proposes the index of proportionality as used by Cordazzo (2008) in order to present an alternative assessment of the significance of Romanian accounting regulation (RAR)/IFRS differences. We use the following formula for total proportionality indexes:

$$TPI_{\text{netincome}} = \frac{\text{net income}_{\text{RAR}} - \text{net income}_{\text{IFRS}}}{\text{net income}_{\text{IFRS}}}$$

$$TPI_{\text{equity}} = \frac{\text{equity}_{\text{RAR}} - \text{equity}_{\text{IFRS}}}{\text{equity}_{\text{IFRS}}}$$

The general assumption is that the IFRS net income (equity) is a synthesis of the differences between the Romanian accounting regulation and IFRS in the process of conversion to IFRS. In this paper we suppose that the IFRS net income (equity) is the result of accounting adjustments applied to Romanian net income (equity).

If the extent presented is null, the ratio is 0.0 that means there are no differences between the Romanian value and those under IFRS. A value of index higher than 0.0 shows the Romanian accounting results are higher than those reported under IFRS and an index lower than 0.0 shows the Romanian accounting result is lower than those reported under IFRS. The net income or equity reported under IFRS is chosen as the denominator. Using them in this index calculation the comparison across countries could be analysed.

In our sample, presented further, the process of conversion to IFRS produces a negative impact on Romanian accounts (see example).

According to previous empirical studies, the value of total indexes of proportionality is classified on range of 5%-10% of RAR/IFRS accounting differences. Outliers’ values have been supposed to appear when the total proportionality indexes are below or above a 300% differences. These values were removed for calculating the mean values.

3. Sample

The sample of companies includes all the Romanian companies which were required to present their individual financial statements under IFRS at December 31, 2012, according to Order 881/2012. We’re taking into account 67 Romanian companies, listed companies on “Bursa de valori București” (the list is available on http://cnvm.ro/pdf/diverse/Lista-societati-incidente-OMF-2012.pdf).

We have evaluated the reconciliation statements between Romanian accounting systems (RAR) and IFRS for year 2011, year for which this reconciliation was done by almost all those companies.

The reconciliation statements of 67 companies are examined at the date of transition to IFRS (Table 1).
Table 1 – Sample selection criteria

| Listed companies on Romanian stock exchange as at December 31, 2012 | Number of entities |
|---------------------------------------------------------------|-------------------|
| **Total**                                                     | 67                |
| Less:                                                         |                   |
| - companies exempted from producing IFRS individual financial statements (there were no longer listed companies) | 1                 |
| - companies not providing IFRS individual financial statements | 1                 |
| **Final number of companies**                                 | 65                |
| Companies providing both net income and shareholders’ equity reconciliation | 50                |
| Companies not providing reconciliation                        | 15                |

The analysis excludes two companies: one was no longer listed company and one did not prepare individual financial statements according with IFRS. Finally, the total sample represents 65 listed companies.

4. Results

Table 2 shows the total impact of the adoption of IFRS on equity and net income for those 65 Romanian companies. Romanian net income is on average 7.8% higher than IFRS reported net income and in case of 18.46% of companies Romanian net income exceeds with more than 10% IFRS net income. Romanian equity is on average 1.78% higher than IFRS reported equity. This result is demonstrated by the highest percentage of companies with an index around the neutral value of 0.0 (Table 3). It is surprising that from our sample no differences have been presented regarding the net profit when the IFRS individual financial statements were presented for 19 companies. The same Remark when the IFRS equity has been presented: no differences were revealed by 10 companies. How can this result be explained? In our opinion, this issue can be explained, among other, as follows:

- A possible lack of conformity in IFRS application;
- In the last years, the Romanian accounting regulation was modified and many accounting treatments were complying with IFRS;
- The companies were not interested in the information under IFRS, so IFRS transition was not seen like a positive process with an important impact of the quality information.

The study of Cordazzo (2008) did not find the same negative decrease of IFRS vs. national net income and equity. That study was done on consolidated financial statements and like other studies (Jermakowicz, 2004, Boukari&Richard, 2007) revealed a positive increase of IFRS vs. national net income and equity. Kubičkova and Jindrikovska, 2012, presented that were no statistically important differences resulting from IFRS adoption in Czech Republic, conclusion which is closed with ours.

Table 2 - Descriptive statistics for total indexes of proportionality

| Net income | Equity |
|------------|--------|
| **Mean**   | 0.078407 | 0.017853 |
| **Median** | 0.000000 | 0.005870 |
| **Maximum**| 2.191539 | 2.169667 |
| **Minimum**| -0.670100 | -2.052371 |
| **Std. Dev.** | 0.423376 | 0.529115 |
| **Observations** | 64 | 64 |

Table 3 - Distribution of total indexes of proportionality

| TPI | Net income | Equities |
|-----|------------|----------|
| **Number of entities** | **Frequencies** | **Number of entities** | **Frequencies** |
| **RAR < -10% vs. IFRS** | < -0.10 | 7 | 10.77% | 9 | 13.85% |
| **-5% < RAR < -10% vs. IFRS** | -0.999 - -0.05 | 5 | 7.69% | 3 | 4.62% |
| **RAR ±5% vs. IFRS** | -0.0499 – 0.0 | 8 | 12.31% | 7 | 10.77% |
| **5% < RAR < 10% vs. IFRS** | 0.01 - 0.0499 | 30 | 46.15% | 26 | 40% |
| **RAR > 10% vs. IFRS** | 0.05 - 0.0999 | 3 | 4.62% | 4 | 6.14% |
| **RAR > 10% vs. IFRS** | > 0.10 | 12 | 18.46% | 16 | 24.62% |
| **Total** | 65 | 100% | 65 | 100% |
Conclusion

Using IFRS for presentation of financial statement of individual accounts represent much more than a change in accounting rules. Our main concern is to understand how the accounting differences could affect the performance of Romanian listed companies. This study examines the mandatory adoption of IFRS accounting reporting standards in Romania for 67 listed companies. Using net income and equity we find empirical evidence of the size and nature of the differences between Romanian accounting regulation and IFRS. The initial adoption of IFRS in 2012, and the requirement that companies restate their comparative 2011 figures to IFRS in 2012 filing, provides an opportunity to compare the numbers for net income and equity under two different sets of accounting rules. After a quantitative analyze done in this paper we’ve found that the impact of application IFRS on net income is relative reduced and the same tendency was found related to equity. The net income and equity under IFRS are lower than net income and equity provided under Romanian accounting regulation. Surprisingly, a lot of companies have no differences between net income under IFRS and net income under RAR. We have the same conclusion when the IFRS equity is presented.

We did not focus in our study on the most important adjustments and their impact on net income and equity. Maybe this is the most important limit of this study. A most relevant analysis could be done if all the adjustments presented by companies could be analysed and quantified.

The goal of IFRS adoption is to provide financial markets with high quality information, improving their efficiency and increasing the way that companies have to access capital. In this respect, the mandatory adoption of IFRS accounting standards in Romania could have a positive reaction on stock market. This reaction could be investigated in the future.

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