

# The Benefits of IFRS Adoption – A survey of Chief Financial Officers of Romanian Listed Companies

Lucian Munteanu

**Abstract**—The move towards internationalization of accounting encountered a great boost, when in 2002 EU delegated the IASB to provide the accounting standards to be applied inside its frontiers. Among the incentives of the standardization of accounting on the international level, is the reduction of the cost of capital. Romania made the move towards IFRS before EU, when the country was not yet a member of it. Even if this made Romania a special case, it was scarcely approached. The leak of real data is usually the reason for avoiding. The novelty of this paper is that it offers an insight from the reality of Romanian companies and their view regarding the IFRS. The paper is based on a survey that the authors made among the companies listed on the first two tiers of the Bucharest Stock Exchange (BSE), which are basically, the most important companies in the country.

**Keywords**—Cost of capital, IFRS, information asymmetry, transparency

## I. INTRODUCTION

WHEN in 2002 the EU decided to request that all listed companies prepare consolidated accounts based on International Financial Reporting Standards (IFRS), Romania not yet a member at the EU at that time, had already recorded an experience with the standards. Without considering being a competition among countries, we would expect at this moment to have a consistent scientific assessment of the effects of the adoption. Although, from a perspective of costs vs. benefits, the first part was scientifically covered by at least one empirical study [9], the second part of the comparison is still not sufficiently approached. By adopting IFRS, it is expected an increase in the disclosure quality of the financial statements of the companies. This will have an inverse effect on the information asymmetry and on the risk, which consequently reduce the cost of capital. The well known statement of Arthur Levitt [1] “The truth is, high [accounting] standards lower the cost of capital. And that’s the goal we share” does nothing but sustain the idea of a correlation existence. Sir David Tweedie (former president of IASB) [13] share the same view, when saying regarding the IFRS, they: “[...] should reduce the cost of capital and open new opportunities for diversification and

improved investment returns.” However, recent research showed that this assumption is not valid in all circumstances, the cost of capital being influenced by many factors (as the capital market efficiency, the importance of the capital market in the companies financing, the quality of corporate governance and investors protection, etc.) that can diminish or even cancel the influence of a superior quality financial reporting.

The mandatory adoption of IFRS in EU started in 2005. The results of scientific studies show sometimes divergent opinions regarding the international accounting harmonization. Basically, there are two concurrent opinions. First, instead of a Babel type accounting, a single business language would improve the international comparability of the financial statements, and this attracts new investors. Much more, in countries characterized by a low quality disclosure, IFRS will increase the quality because of its high quality requirements. The recent studies of Mangena [11] and Chen [7] sustain this. Romania can be considered such a case.

The second point of view emphasize on the importance the companies gives to the financial market. The companies based in countries where the culture of financial market is on a low level, are usually more reluctant than enthusiastic in adopting the IFRS. On the opposite, the companies from countries where capital market is the main financing source, the companies are used with the requirements of investors, and are more opened to respond for a better quality of information disclosure, because in the end, this will offer them more trust from the investors, and the capital on a lower cost. On this approach, it is expected that the greatest impact of IFRS adoption to be found in countries with a high developed financial market and a high quality disclosure requirements.

As the IFRS are in fact developed for the countries like UK and USA, when they are mandated in countries based on debt rather on financial market, the results might not be as some would expect. Even if the standards attracts the international capital, it might be possible that the companies to show low interest for them, and much worst, they might consider the new disclosure requirements more as a burden than a benefit.

Studies like the one of Leuz and Verrecchia [2] show evidence of capital cost reduction when the standards are voluntarily adopted, while regarding the mandatory adoption, the studies where for a long time unclear [5],[6]. But still, there are at least two reasons why we should expect a reduction on the cost of capital, even if the standards are mandatory adopted. First of all, IFRS compared with local standards, has higher requirements for financial information

Lucian Munteanu is a PhD candidate, assistant researcher in the Department of Economic Research of the Bucharest Academy of Economic Studies, Piața Romană, Nr.6, Romania (phone: +40.752.036.026; e-mail: lucian.munteanu@ase.ro).

The present paper is issued with the financial support offered by CNCIS – UEFISCSU through the project PNCDI II: ID 1840/2008/IDEI II: “*The benefits of IFRS adoption: an exploratory research regarding the impact of the internationalization of Romanian accounting on the cost of capital*”

disclosure [8], and as Botosan [3] and Lambert [12] sustain, this reduce the cost of capital. Secondly, in Armstrong view [4], the improved comparability between companies reduces the cost of capital.

Siqi Li [14] shows empirical evidences on the EU level, that the companies, who mandatory adopted IFRS after 2005, recorded a significant reduction on the cost of capital. In opposition to this category, the companies that voluntarily applied IFRS after 2005 recorded no significant reduction on the cost of capital.

In some of our previous research [10]) we showed that in Romania, there is no relationship between the cost of capital and the quality of financial reporting. However, the results must be prudently interpreted, because the model we used in estimating the capital cost was based on real data and not on the analyst's forecasts. Also, the model we used did not include any variable to show the possible effect of inefficiency of the Romanian capital market. Even if the results are not highly accurate, they offer hints that the capital cost of the Romanian companies is influenced on some factors that must be further identified and analyzed. We therefore, developed a survey, to get some insight views from the companies.

## II. SURVEYING THE ROMANIAN LISTED COMPANIES

### A. The Survey- Methodology

Our survey was based on a questionnaire (Appendix A), constructed in order to get some relevant views of the companies regarding the IFRS adoption in Romania in general, and in their cases in particular. We choose only the companies listed on Bucharest Stock Exchange (BSE), on the first two tiers. Basically, these are the biggest and most important listed companies, which qualify for the superior criteria imposed by BSE for the first tiers.

The procedure was to obtain the contact information of the financial managers of these companies, and than, send the questionnaire on their e-mail address, accompanied by a cover letter.

From our previous experience, we knew that this is going to be a taught task, because most of the time, the companies are reluctant to respond to any kind of questionnaires. The reason in the first place, is that the financial managers are always overwhelmed with their current tasks. Secondly, transparency is most of the time considered a threat, because of the communist background of the country. So, we had to convince them of the utility of the survey, and the importance of their view. After we sent the questionnaire through e-mail to the financial directors for the first time, the response rate was very

TABLE I  
COMPANIES THAT ARE NOT WILLING TO APPLY IFRS

	Frequency	Percent
No	32	86.5
Yes	5	13.5
Total	37	100

low. To increase the response rates, we phoned to each finance director and reminded him or her about the questionnaire. Thirty-seven questionnaires were returned, achieving a response rate of 53%. The first questionnaire was returned in

the second half of November 2010, and the last in the second half of April 2011.

In figures, we sent approximately 300 emails, and had around 200 phone call conversations, for an amount of 70 companies listed on the first two tiers of the BSE. The campaign started on November 2010, and ended in April 2011. The survey results were then introduced and processed in the SPSS.

### B. The Research Hypothesis

Our first objective was to find the reason why Romanian companies apply, or are willing to apply the IFRS. As it is known, the IFRS increase comparability of the financial statements, and that makes the companies eligible to access foreign finance, from international markets. So we wanted to see, if the main reason why Romanian companies apply the IFRS, is the foreign financing opportunity. Accordingly, we set our first hypothesis:

**H<sub>A1</sub>:** The reason why Romanian enterprises apply/are willing to apply IFRS is to access foreign financial markets.

We also wanted to see if there is a difference when considering the type of capital of the companies. Does the foreign investors put more pressure on the companies for IFRS adoption, or there is no difference between Romanian and foreign investors behavior? We therefore, set the next hypothesis:

**H<sub>A2</sub>:** The companies that are wholly or majority owned by foreign investors apply IFRS.

Further, we wish to see another important feature of the Romanian business environment, and that is: what is the main source that the Romanian enterprises use for financing their development? Is it the capital market, banks or they auto finance with their own resources? To answer this question, we set the next hypothesis:

**H<sub>A3</sub>:** The enterprises that use capital markets as their main financing source are more interested in using the IFRS than the companies which use other financing sources.

As several studies show, it is expected usually that in countries where the disclosure requirements are on a low level, the impact of IFRS would be considerable, and would bring benefits for the companies that reports under IFRS. If the companies put more emphasize on obtaining the capital from banks, and are not very much interested of the capital market, we won't expect them to be enthusiastic about IFRS.

## II. RESULTS AND FINDINGS

### A. Reason of IFRS Adoption

From the sample of the companies, which comprise 37 companies, we found that 13.5% of them are not applying IFRS, and are not interesting to do it in the nearest future. As it can be seen in Table 1, from our sample, only 86.5% can be used to answer on our first objective.

Further, when we analyzed the reason for adopting IFRS, we discovered that 31.3% of the companies apply IFRS from more than one reason (Table 2). But predominantly, 78.1% of the finance directors said that their companies apply IFRS

because of the mandatory regulation. On the second rank, in equal measure of 21.9%, the reasons are: management initiative and need for foreign financing. Lastly, only 9.4% of the companies apply IFRS under the pressure of the shareholders.

TABLE II  
REASONS FOR IFRS REPORTING

Reason for IFRS reporting	Responses		Percent of Cases
	N	Percent	
Mandatory regulation	25	59.5%	78.1%
Management initiative	7	16.7%	21.9%
Shareholders pressure	3	7.1%	9.4%
Need for foreign financing?	7	16.7%	21.9%
	42	100.0%	131.3%

In this case, the hypothesis  $H_{A1}$ , cannot be accepted as valid. The main reason of adopting IFRS is not the need for foreign financing. In addition, we wanted to see comparatively, how much the companies use the foreign financing strategy in order to obtain their capital. The results are shown in Table 3:

TABLE III  
POSITION REGARDING FOREIGN FINANCING

	Position regarding foreign financing				Total
	Frequent	Occasional	Willing	Not Interested	
Count	2	4	11	8	25
% foreign financing	8.0%	16.0%	44.0%	32.0%	
Count	3	3	1	0	7
% foreign financing	42.9%	42.9%	14.3%	.0%	
Count	5	7	12	8	32

Investigating more, we wanted to see, what type of IFRS reporting the companies apply, or are willing to apply: consolidated reporting, or individual reporting. The results are to be seen in Table IV.

TABLE IV  
TYPE OF IFRS REPORTING

Type of reporting	Responses		Percent of Cases
	N	Percent	
Consolidated	19	41.3%	51.4%
Individual	12	26.1%	32.4%
Will for Consolidation	2	4.3%	5.4%

Will for Individual	8	17.4%	21.6%
Not willing	5	10.9%	13.5%
Total	46	100.0%	124.3%

As a company can apply either consolidated and individual reporting, or just one of the options, the question was expecting a multiple answer. There are cases when a company applies only one of the types. In the next cross-tabulation (Table 4), we can see that there are 6 companies (24%) that apply both consolidated and individual type of reporting.

TABLE V  
CROSS-TABULATION - CONSOLIDATED\*INDIVIDUAL

		Individual		Total
		No	Yes	
Consolidated	No	12	6	18
	Yes	13	6	19
Total		25	12	37

#### B. Capital Ownership Influence on the IFRS Adoption

When we considered the second hypothesis, we compared how the type of capital influence the application of the IFRS among the companies analyzed. Using a crosstab (Table 6) we observed that all the companies that are wholly or majority owned by foreign investors, apply IFRS, either in a consolidated form, either in individual form, or both. The Romanian investors on the other side, seems to be not as much interested on the IFRS application by the companies, as the foreign investors.

TABLE VI  
CROSSTAB: TYPE OF REPORTING - CAPITAL OWNERSHIP

Type of reporting		Capital Source		Total
		Romanian	Foreign	
Consolidated	Count	14	5	19
	%	73.7%	26.3%	
Individual	Count	10	2	12
	%	83.8%	16.7%	
Will for consolidation	Count	2	0	2
	%	100.0%	0.0%	
Will for individual	Count	8	0	8
	%	100.0%	0.0%	
Not willing	Count	5	0	5
	%	100.0%	0.0%	
Total		31	6	37

Considering that 100% of the companies wholly or majority owned by foreign investors apply IFRS, we can accept the  $H_{A2}$  hypothesis.

#### C. Source of Financing Influence on the IFRS Adoption

When testing the  $H_{A3}$  hypothesis, we used again a crosstab for comparison of different variables. Because five respondents gave multiple responses instead of a single

response on the question regarding the main finance source, we couldn't take into consideration their responses. Looking into the Table 7, we can see that capital market is far away from being the main source of financing for the companies in our sample. The auto-financing, is ranked first, and then the banks. This is something characteristic for continental countries, based more on debt, and continental law system. We therefore, reject the hypothesis  $H_{A3}$ .

TABLE VII  
CROSSTAB: TYPE OF REPORTING - FINANCING

	Financing Source			Total
	Bank	Capital Market	Auto Finance	
Consolidated	7	2	8	16
Individual	4	1	7	11
Will for Consolidation	0	0	2	2
Will for Individual	2	0	5	7
Not willing	3	0	1	4
Total	15	2	17	32

### III. CONCLUSION

Our study objective was to find the views of financial directors of the most important companies in Romania, with regard to IFRS adoption by their companies, and in general. In order to achieve our goal, we surveyed the chief financial officers of the companies listed on the first two tiers of the BSE. The uniqueness of our study is that it is based on real data collected in Romania, a country well known for the high degree of leak of data for research. Our conclusion is that most of the companies apply IFRS not voluntarily, but forced by regulation. It is not their will to access the international financial markets, not the management initiative, nor does the shareholders pressure, but the regulation that makes them apply the IFRS. This state of facts, can be characterized as a "adopting a label" not a voluntarily strategy, as Daske et al (2009) considers. When we consider the capital source of the companies under analysis, we conclude that the companies which are wholly or majority owned by foreign investors, are the first interested to use IFRS. This fact is something that we would expect, as the Romanian markets opened more and more, and since 2007 it became a member of EU. There are currently many multi-national companies active in Romania, and the number will increase even more, if we take into account, that the labor costs are still lower.

The findings of our study are consistent with the financial literature, as we presented in the introduction. Romania is a country in which, the culture of the financial market is on a low level, the companies finance their activity and development from banks, and their own resources.

### APPENDIX A

Academy of economic studies bucharest center for accounting and management information systems. Questionnaire Regarding the institutional factors that influence the application of IFRS in Romania

#### *Directions for filling in the questionnaire:*

Excluding the case when where several answers may be chosen, please fill the column on the right with the one option you consider appropriate for your enterprise.

- Your enterprise applies International Financial Reporting Standards (IFRS) (several answers can be chosen):
  - in consolidated financial reporting;
  - in individual financial reporting;
  - does not apply IFRS, but is willing to apply in consolidated financial reporting;
  - does not apply IFRS, but is willing to apply in individual financial reporting;
  - is not interested to apply IFRS (please continue with the question no.4).
- Since when does your enterprise apply IFRS?
- The application or the willingness for IFRS application is your enterprise is due to:
  - mandatory regulation;
  - management's initiative;
  - shareholders pressure;
  - the need for foreign financing?
- Generally, in your opinion, the implementation of IFRS reporting system gives the following advantages (several answers can be given):
  - it is an appropriate accounting system for the listed companies as it offers relevant information to investors;
  - permits access to the foreign financing market;
  - offers solutions for transactions not yet regulated;
  - offers managers a good information resource for decision making;
  - it is a straightforward accounting system;
  - other advantages, please specify:
- In your opinion, you consider that IFRS adoption can improve the quality of information disclosure because: (several answers may be chosen)
  - IFRS uses more requirements for information disclosure;
  - reporting under IFRS provide useful information for decision making and forecasting;
  - reporting under IFRS is based in a great measure on the fair value;
  - application of IFRS offers comparability on the international level;
  - other reasons, please specify:
- Comparatively, do you consider that the implementation of IFRS in Romania was made as it was made in the developed countries of EU
  - yes, the implementation follows same norms (please continue with question number 8);
  - no, because the application is influenced by the local environment;

- c. it cannot be appraised (please continue with question number 8).
7. Which are the factors characteristic to the Romanian environment, that does not allow an application comparable with the one made in the developed countries of EU? (several answers may be chosen):
  - a. the connection of accounting to taxation;
  - b. the lack of an active market for establishing the fair value;
  - c. different professional judgment;
  - d. management attitude on risk and incertitude, when they make accounting appraisals;
  - e. lack of incentives for a complete application, when considering that the main source of financing is the banking system;
  - f. the quality of financial audit;
  - g. the employees are not prepared and does not have the required experience;
  - h. other reasons, please specify:
8. Particularly, in the Romanian capital market, do you consider that the adoption of IFRS by your enterprise improved/will improve the quality of information disclosure
  - a. yes, in a great measure;
  - b. yes, in a low measure;
  - c. it cannot be appreciate;
  - d. the application of IFRS has no impact on the quality of financial reporting on the Romanian capital market.
9. Particularly, in the Romanian capital market do you consider that the IFRS features regarding the improvement of the information for investors are diminished because of the following: (several answers may be chosen)
  - a. financial statements in conformity with IFRS are not useful for establishing the dividends;
  - b. financial statements in conformity with IFRS are not useful for establishing the taxable profit;
  - c. the obligation for double reporting (in accordance with the Accounting Regulation in conformity with the EU Directives and IFRS) leads to a baffling image for the investors and financial analysts;
  - d. the capital market is inefficient, the stocks prices doesn't have any reaction to a better quality information;
  - e. the investors are interested mainly in protection options (improving the governance) and not in the quality of the financial statements;
  - f. other reasons, please specify:
10. For the application of IFRS, your enterprise uses/used consulting provided by:
  - a. a foreign consultant/consultancy;
  - b. a domestic consultant/consultancy;
  - c. has not received/does not receive consulting services.
11. What is your enterprise's relationship with the foreign financial market?
  - a. it frequently resorts to this type of financing;
  - b. it occasionally resorts to this type of financing;
  - c. does not resort to foreign financing market at present, but is willing for this type of financing;
  - d. it is not interested in this type of financing.
12. What is the main source of your company financing:
  - a. banks;
  - b. capital market;
  - c. auto-financing.
13. The share capital of your enterprise is::
  - a. wholly or majority owned by Romanian shareholders;
  - b. wholly or majority owned by foreign shareholders.
14. You have a professional experience in accounting-finance of:
  - a. less than 10 years;
  - b. between 10-20 years;
  - c. greater than 20 years.

## REFERENCES

- [1]. A. Levitt, "The Importance of High Quality Accounting Standards", *Accounting Horizons*, 1998, 12(1):79-82.
- [2]. C. Leuz, R. Verrecchia, "The economic consequences of increased disclosure", *Journal of Accounting Research*, 2000, 38 (Supplement): 91-124.
- [3]. C.A.Botosan, "Disclosure Level and the Cost of Capital", *The Accounting Review*, 1997, Vol.72, No.3, pg 323-349
- [4]. C. Armstrong, M. Barth, A. Jagolinzer, and E. Riedl, "Market reaction to the adoption of IFRS in Europe", *The Accounting Review*, 2010, 85 (1): 31-61.
- [5]. Daske H., L. Hail, C. Leuz, and R. Verdi. (2007). "Adopting a label: Heterogeneity in the economic consequences of IFRS adoption". Working paper, University of Mannheim, the Wharton School, University of Chicago, and MIT, available at: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1502413](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1502413)
- [6]. Daske H., L. Hail, C. Leuz, and R. Verdi (2008). Mandatory IFRS reporting around the world: Early evidence on the economic consequences. *Journal of Accounting Research* 46 (5): 1085-1142, disponibil si la: <http://ssrn.com/abstract=1024240>
- [7]. H. Chen, Q Tang., Y. Jiang , Z. Lin, "The Role of IFRS in Accounting Quality: Evidence from European Union", *Journal of International Financial Management & Accounting*, 2010, Vol.21 (3)
- [8]. H. Ashbaugh, M. Pinicus, "Domestic Accounting Standards, International Accounting Standards, and the Predictability of Earnings", *Journal of Accounting Research*, 2001, 39 (3): 417-434.
- [9]. I.Ionaşcu, M. Ionaşcu, L. Olimid, D.A. Calu, "An Empirical Evaluation of the Costs of Harmonizing Romanian Accounting with International Regulations (EU Directives and IAS/IFRS)", *Accounting in Europe*, 2007, Vol.4.Issue 2, pp 169-206.
- [10]. L. Munteanu, I. Ionaşcu, M. Ionaşcu, "Disclosure quality and the Cost of Capital: Evidence for Romania", *Financial Audit*, 2011, Vol.9, No.1, pp.16-20.
- [11]. M. Mangena, R. Pike, J. Li (2010). Intellectual Capital Disclosure Practices and Effects on the Cost of Equity Capital: UK Evidence, Published by *The Institute of Chartered Accountants of Scotland*, (2010) online available: [http://www.icas.org.uk/site/cms/download/res/mangena\\_pike\\_Report\\_April\\_2010.pdf](http://www.icas.org.uk/site/cms/download/res/mangena_pike_Report_April_2010.pdf)
- [12]. R. Lambert, C. Leuz, and R. Verrecchia, "Accounting information, disclosure, and the cost of capital". *Journal of Accounting Research*, 2007, 45 (2): 385-420.
- [13]. S. D. Tweedie, "Prepared statement of Sir David Tweedie, Chairman of the IASB, before the Economic and Monetary Affairs Committee of the European Parliament", (2006), available online: <http://www.iasplus.com/resource/0601tweedieeuspeech.pdf>
- [14]. Siqi Li, "Does Mandatory Adoption of International Financial Reporting Standards in the European Union Reduce the Cost of Equity Capital?", 2010, *The Accounting Review*, Vol.85, No.2, pp.607-636



**Lucian Munteanu** was born in Pitesti in May 31, 1984. He graduated from the University of Pitesti the Faculty of Accounting and Management Information Systems in 2007. He was ranked the first graduate in his generation. After graduation, he enrolled in the PhD school of the Bucharest Academy of Economic Studies, where currently, he is developing his PhD thesis, entitled: "Accounting convergence and its impact on the cost of capital". In 2009, he became a member of

IAAER. Lucian has a wide accounting practical experience, being the CAO in a private owned company. He also has experience in teaching, as he used to work for University of Pitesti as an assistant professor. He also has experience in research, being currently employed in the Research Department of the Bucharest Academy of Economic Studies. In 2010, he published the article: "Does IFRS reduce the Cost of Equity? In search for a suitable Romanian proxy – A journey through the financial Literature" in the AMIS 2010 – Proceedings of the 5<sup>th</sup> International Conference, Accounting and Management Information Systems – Bucharest, (pp.892-902) indexed in the ISI Web of Knowledge