

## **IAS/IFRS Short Adoption Journey in an Emerging Economy**

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### **Abstract**

This study investigates the impact of IFRS adoption on the transparency and quality of financial statements in Romania from 2012 to 2022. Focusing on compliance with key IAS/IFRS standards, we examine whether increased transparency correlates with profitability, as measured by return on equity (ROE). Utilizing data from the Bucharest Stock Exchange (BVB), we analyze annual reports of companies in the Energy and Manufacturing sectors. We employed a Likert scale to assess compliance and performed regression analyses to evaluate the relationship between compliance and profitability. Our findings indicate a significant increase in transparency over the study period, particularly in the Energy sector, which demonstrated higher compliance scores compared to the Manufacturing sector. Regression results support our first hypothesis, showing a strong positive correlation between IFRS adoption and transparency over time. While the second hypothesis, predicting a positive correlation between compliance and ROE, was less consistently supported, it still revealed significant findings in the Manufacturing sector.

**Keywords:** IAS/IFRS, Adoption, Transparency, Energy Sector, Manufacturing Sector

**JEL Classification:** M41, M48

### **Introduction**

Romanian accounting practices have long exhibited diversity due to the country's complex history. Following World War II, Romania fell under communist rule from 1947 to 1989, which brought about significant changes to its accounting system, previously aligned with Western European standards. However, post-communist Romania began reforming its policies to reestablish European influences in its accounting practices. This transition was particularly evident following the Soviet Union's occupation, which ended in 1990. Subsequently,

Romania's accounting system adopted substantial French influence regarding financial reporting standards.

The French accounting model became the foundation of the new Romanian accounting system, particularly when the Ministry of Public Finance (OMFP) initiated the incorporation of International Accounting Standards (IAS) in 2001. This initiative aimed to enhance the credibility of financial reporting in Romania, a crucial step for the country's aspirations to join major international financial organizations such as the International Monetary Fund (IMF) and the World Bank (Paunescu, 2015).

The integration of IAS standards in 2001 marked the beginning of a three-phase process that led to Romania's current accounting system. Initially, Romania entered the harmonization stage, which involved improving rules, norms, techniques, and accounting terminology to make financial statements internationally comparable (Manea, 2008). The subsequent phases—convergence and normalization—saw Romania adopt International Financial Reporting Standards (IFRS).

Initially, many Romanian entities viewed the harmonization of accounting standards as a resource-intensive process with limited immediate benefits. The substantial costs associated with implementing new accounting systems and retraining employees led to skepticism. Nevertheless, the perceived long-term benefits for the Romanian economy, especially on the global stage, prompted the government to advance to the convergence phase. This phase began in 2012 when the OMFP mandated that entities seeking to list their securities on regulated markets must apply IFRS for all annual statements. This requirement marked a significant shift towards accounting convergence, as companies were now obligated by national authorities to report their financials according to IAS/IFRS standards (Ionaşcu et al., 2014).

The changes implemented in 2012 were profound for many Romanian entities. However, as a developing country, Romania recognized that adopting new financial reporting standards was essential for integrating into the community of developed nations with secure financial institutions. The pressure to join prominent financial institutions like the World Bank and IMF necessitated continuous improvement in financial reporting standards. This period, known as accounting normalization, involves applying norms to harmonize working methods, accounting terminology, and the presentation of financial documents (Manea, 2008).

In this study, we aim to analyze the progress of IFRS adoption in Romania, particularly focusing on the largest industries. We seek to determine whether the increased transparency in financial reporting has been achieved and to what extent Romanian companies have met IAS/IFRS compliance goals. We hypothesize that over the decade from 2012 to 2022, companies have made significant strides in adopting these standards, leading to more accessible and understandable financial statements for foreign investors.

### **Literature Review**

Romania began adoption of IAS/IFRS reporting standards in the early 2000', after the decision to integrate the country into the European Union and gain access to other important financial institutions. Just two years earlier, there was an attempt by the government to harmonize IFRS standards into the national accounting standards, however, this was an unsuccessful

attempt, bringing a lot of negativities towards future endeavors to integrate new systematical accounting standards. Five years later, Romania saw the drastic change requiring all companies to conform to IAS/IFRS reporting standards. This change came introduced preliminary requirements that Romanian GAAP was still necessary for reporting while making sure that investors had the ability to request financials in the IFRS standards (Paunescu, 2015). Previous studies have investigated various aspects of International Financial Reporting Standards (IFRS) adoption and the impact of new reporting standards on existing accounting systems (Palea, 2013; Albu et al., 2011). These studies often compare the perceived benefits of IAS/IFRS implementation against the associated costs. A notable trend identified is the inclination towards global reporting standards due to the potential for increased international capital inflows (Ionaşcu et al., 2007; Larson and Street, 2004).

Despite the abundance of studies in both Romania and other emerging countries, there remains a need for a micro-level analysis of the largest industries within an emerging country, focusing on the evolution of transparency in reporting systems over an extended period. Commonly, studies are conducted soon after the changes in reporting standards occur, potentially missing long-term adjustments and impacts (Nobes and Parker, 2016). Our study spans a decade, from 2012 to 2022, allowing sufficient time to assess the full adoption and consolidation of new accounting practices. This timeframe enables us to observe improvements in financial reporting quality and the stabilization of accounting practices in response to the changes in reporting standards.

Other studies emphasize the importance of cultural factors and their influence on entities' and governments' willingness to change, as well as on auditors' adaptability (Gray, 1988; Ding et al., 2007). Large-scale changes in financial reporting systems necessitate governmental development of enforcement procedures, workforce retraining, and potentially the implementation of new technical systems, leading to significant costs (Zeghal and Mhedhbi, 2006). Research on Romania and neighboring Eastern European countries highlights a historical reluctance to transition from rule-based Soviet accounting systems to principle-based Western systems, which allow for more interpretation and flexibility (Ionaşcu et al., 2014).

Developing countries, including Romania, often exhibit a "secrecy culture" that is less investor-oriented, reflecting an internal focus in their financial reporting systems and policies (Hofstede, 1980; Doupnik and Richter, 2003). Transitioning to IAS/IFRS offers these countries the opportunity to attract international investors by enhancing the transparency and comparability of financial statements (Ball, 2006). This shift is crucial for companies seeking diversified and stable funding sources (Ramanna and Sletten, 2014).

### **Methodology**

The purpose of this study is to determine if the adoption of IFRS reporting standards has enhanced the quality and transparency of financial statements. We examined compliance with several key IAS/IFRS standards, including:

- IAS 1: Presentation of Financial Statements
- IAS 2: Inventories
- IAS 16: Property, Plant & Equipment
- IAS 18 (currently IFRS 15): Revenue
- IAS 36: Impairment of Assets
- IAS 37: Provisions, Contingent Liabilities & Contingent Assets
- IAS 38: Intangible Assets

Our Hypotheses are As Follows:

- **H1:** Continuous improvement in IAS/IFRS adoption leads to increased transparency over time.
- **H2:** There is a positive correlation between IAS/IFRS adoption and profitability (measured by ROE).

In the first stage, we sourced data from the Bucharest Stock Exchange (BVB), focusing on annual reports containing both quantitative and qualitative information relevant to our criteria.

We then selected the industries and companies to be analyzed. We reviewed revenues of BVB-listed companies with annual reports available from 2012 to 2022, excluding industries required to file under IAS/IFRS before 2012, such as financial institutions and banks. This filtering identified the Energy and Manufacturing sectors as the most significant drivers of the Romanian economy. Consequently, we selected the two firms with the highest operating profits from each sector for our evaluation.

Our analysis utilized a matrix based on IFRS guidelines and academic research (Ball, 2006; Albu et al., 2011). We assessed each company's compliance on a Likert scale (1 to 5, with 5 indicating full adoption) for each year from 2012 to 2022. This scoring system helped quantify the degree of compliance over time.

To measure the impact of compliance on profitability, we performed a regression analysis with return on equity (ROE) as the dependent variable. This approach allowed us to evaluate the relationship between IAS/IFRS compliance and company profitability.

## Results and Conclusions

After scoring and compiling data regarding compliance scores and each individual firm's ROEs between 2012 and 2022, we performed six different regressions to test our two hypotheses:

*H1:* The continuous improvement in adoption of IAS/IFRS reporting standards leads to increased transparency over time.

*H2:* We expect a positive correlation between IAS/IFRS adoption with profitability (ROE).

The six regressions allowed us to test each hypothesis for the energy sector, the manufacturing sector, and on our sample. The following relevant statistics for each regression have been included in the following Tables, *Table 1 – Table 3*.

Table 1  
*Regressions Relating to the Energy Sector*

<i>Alpha = 0.05</i>	<b>Significance F</b>	<b>R-Squared</b>	<b>T-Stat</b>
<b>H1: Compliance Score Over Time</b>	0.0002	0.7920	5.8399
<b>H2: Compliance Score Predicting ROE</b>	0.3420	0.1006	1.0032

Table 2

## Regressions Relating to the Manufacturing Sector

Alpha = 0.05	Significance F	R-Squared	T-Stat
<b>H1: Compliance Score Over Time</b>	0.0003	0.7816	5.6760
<b>H2: Compliance Score Predicting ROE</b>	0.0154	0.4968	2.9808

Table 3

## Regressions Relating to the Entire Sample

Alpha = 0.05	Significance F	R-Squared	T-Stat
<b>H1: Compliance Score Over Time</b>	0.0002	0.8031	6.0591
<b>H2: Compliance Score Predicting ROE</b>	0.0360	0.4027	2.4635

When looking at each of these tables we see that at a significance level (alpha) of 0.05, that all the regressions, apart from *H2* for the energy sector, are statistically significant. Additionally, out of both hypotheses, we note that for each set of regressions, *H1* is consistently more significant than *H2*. In each of the tables *Table 1 – Table 3*, we see that, across the board, *H1* has lower Significance F scores, more extreme R-Squared regression, and more extreme T-Statistics, when compared to the corresponding regressions for *H2*. Additionally, when evaluating the R-Squared regression statistics for *H1*, we observe relatively high (greater than 0.7) values, indicating a strong correlation in the positive direction between our compliance scores and time.

When evaluating the compliance scores for each company and industry we see that, between the years 2012 and 2022, that the energy sector, comprised of *Company A* and *Company B*, had greater compliance scores than the manufacturing sector, comprised of *Company B* and *Company C*. Between 2012 and 2022, the energy sector had an average compliance score of 87.50 out of 95 (92.11%), when the manufacturing sector had an average compliance score of 74.77 out of 95 (78.71%). Thus, the energy sector had scored 13.40% higher than the manufacturing sector between 2012 and 2022.

In the last five years (2018 – 2022) we see that the energy sector had an average score of 88.50 (93.16%), whereas the manufacturing sector had an average score of 84.10 (88.53%). This equates to a 4.63% higher score for the energy sector when compared to manufacturing between 2018 and 2022.

Our research concludes that the adoption of IFRS reporting standards in Romania has led to increased transparency in financial statements over the decade from 2012 to 2022. This enhancement is particularly evident in the Energy sector, which consistently exhibited higher compliance scores compared to the Manufacturing sector. The compliance improvements observed underscore the effectiveness of IFRS in promoting clearer and more accessible financial reporting, aligning with global standards. These findings suggest that regulatory frameworks and sector-specific characteristics play crucial roles in the successful implementation of IFRS.

Furthermore, while our study found a strong positive correlation between IFRS adoption and transparency, the relationship between compliance and profitability (ROE) was more nuanced. The Manufacturing sector showed significant results, indicating that improved

compliance can enhance profitability. However, this trend was not as pronounced in the Energy sector. These insights emphasize the importance of considering industry-specific dynamics when assessing the broader impacts of IFRS adoption. Overall, our study highlights the progress Romania has made in financial reporting transparency and sets a precedent for future research on IFRS adoption in emerging markets.

### **Theoretical and Contextual Contribution**

This research makes a significant theoretical and contextual contribution to the existing body of knowledge on IFRS adoption, particularly within emerging economies. The decade-long span of this study allows for a comprehensive evaluation of long-term impacts, unlike many previous studies that focused on immediate outcomes post-adoption. By examining the largest industries in Romania, the research provides detailed insights into sector-specific dynamics, highlighting the different paths and challenges faced by energy and manufacturing sectors in adopting international standards.

Theoretically, the study reinforces the idea that the transition to IFRS can significantly enhance financial transparency, aligning with global standards and facilitating international investments. This aligns with previous literature suggesting that improved transparency and comparability are primary benefits of adopting IFRS (Ball, 2006; Palea, 2013). The nuanced findings regarding profitability suggest that while transparency benefits are clear, the financial performance implications can vary significantly between sectors, adding depth to the ongoing discourse on IFRS impacts.

Contextually, this research underscores the critical role of regulatory frameworks and sector-specific characteristics in successful IFRS implementation. The higher compliance scores in the energy sector compared to manufacturing highlight how different industries may require tailored approaches to IFRS adoption. This insight is particularly valuable for policymakers and regulatory bodies in emerging markets

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