

DISCLOSURE PRACTICES CONCERNING CONSOLIDATED FINANCIAL STATEMENTS OF ROMANIANS GROUPS OF ENTITES

Tiron Tudor Adriana
Babes Bolyai University,
Economics and Business Administration Faculty

The main object of this paper is to examine accounting harmonization in a sample of companies with regard to the presentation of consolidated financial statements. The results of the study indicate that listed firms tend to comply with IFRS requirements

Keywords: disclosure, consolidated financial statements, IFRS

JEL: M41

Motivation and objectives

From the beginning of 2005 companies from the European Union have to comply with the International Financial Reporting Standards (IFRS) when reporting their consolidated financial statements, as publicly listed companies subject to Regulation 1606/2002 of the European Union.

European Union (EU) Regulation 1606/2002 was a watershed (Cairns, 2003). EU Regulation 1606 states that "member states are required to take appropriate measures to ensure compliance with international accounting standards" (EC,2002). It requires all listed companies of member states to prepare consolidated financial statements based on IFRS beginning 1 January 2005 (Brown and Tarca, 2005). The announced aim of IFRS adoption in the EU was to improve the quality of companies' financial reporting by increasing its comparability and transparency, and to promote the development of a single capital market in Europe (Federation des Experts Comptables Européens, 1999).

This change affected Romania also, because even if the country gained membership only in 2007, therefore it had to be prepared and implement IFRS in the domestic accounting regulation. This problem was solved by changing the national accounting regulations.

The objective of this study is to analyze if the Romanian groups respect or not the requirements concerning the disclosure of consolidated financial statements. In our sample were included just financial and non-financial companies listed at BVB, first category.

Romania has now only one stock exchange: the Bucharest Stock Exchange (BVB). BVB has a total of 2,078 listed securities, 59 on the main market (BVB) and 2,019 on the unregulated market (previously known as RASDAQ). Most of the securities listed on the RASDAQ are not traded at all and are the result of the early privatization of state owned enterprises.

For the purpose of our paper, information from annual reports of the Romanian companies in the sample has been collected for the period 2006-2008 with a special focus on the consolidated financial statements. This data allowed us to observe the evolution of harmonization process concerning the disclosure of consolidated financial statements, and for each year the degree of material disclosure harmonization.

Our objective was to calculate the material disclosure harmonization for consolidated financial statements, which tests the extent of the information disclosed through the consolidated financial statements. So, we analyzed if the consolidated financial statements of the selected groups disclose certain information.

The paper is organized as follows. In the next two chapters we present a short review of the Romanian accounting regulation concerning consolidated financial statements and growing literature which is important is setting the context of the study as well as the hypotheses. This is followed by discussion of

methodology of research. In the fifth part findings are critically evaluated and then the conclusions chapter closes the paper.

Legal framework concerning the disclosure of consolidated financial statements in Romania

Accounting rules are aligned with the Fourth and Seventh Company Law Directives, as well as with the Transparency Directive, the IAS Regulation (EU Regulation 1606/2002), and the Bank and Insurance Accounts Directives. Since 2007, listed companies have been required to use International Financial Reporting Standards *as endorsed* by the EU to prepare their consolidated financial statements. Financial statements are available at the trade registry, albeit not electronically.

CNVM Orders 75/2005 and 74/2005 transpose respectively the Fourth and Seventh Company Law Directives for companies that the CNVM regulates and supervises. Listed companies regulated by CNVM prepare their consolidated financial statements under *endorsed* IFRS.

The Accounting Law 82/1991 amended and republished sets the obligations to prepare consolidated financial statements for a parent company.

In 2005, The Ministry of Finance (MoF) Order 1752/2005 seeks to cover financial reporting requirements applicable to companies of all sizes in one piece of legislation, with differing levels of disclosure according to the size and public interest consideration. The MoF Order 1752/2005 has been effective from January 1, 2006 for reporting year ending December 31, 2006.

The following types of entities were required to comply with the applicable elements of IFRS: financial lending institutions, insurance and re-insurance companies, listed entities and entities with securities traded on a regulated market, state-owned entities and entities that benefit from state support or state guarantees.

The preparation of financial statements based on IFRS for the financial year ending in 2006 was required for 2007 IFRS compliance to enable comparatives to be available for 2007 reporting.

OMF 1752 provides for exemptions. Entities other than public-interest entities are exempt from preparing consolidated financial statements if, at balance sheet date, the entities to be consolidated do not together exceed the limits of two of the following three criteria: total assets of EUR 17,520,000; turnover of EUR 35,040,000; and average number of employees during the financial year of 250. A group (if not a listed entity) may be exempt from preparing consolidated financial statements if more than 90% of the parent company belongs to another group. Public-interest entities, other than banks and listed companies, prepare their consolidated financial statements in accordance with either *endorsed* IFRS or accounting standards compliant with the Seventh Company Law Directive.

The provision of OMF 907/2005 providing that banks have to prepare a set of consolidated financial statements in accordance with IFRS for the year ending 31 December 2006 has been confirmed by OMF 1121/2006 for subsequent periods (however in accordance with *endorsed* IFRS). MoF Order 1121/2006 provides some additional guidance on the application of IFRS commencing with the year ending December 31, 2007.

The Company Law obliges the Management Board of the parent company to publish the annual financial consolidated statements at the trade registry within 15 days from the date of their approval.

Literature review

Disclosure harmonization is concerned with the extent of information disclosure and measurement harmonization is concerned with the nature of the information disclosed. Van der Tas (1988)

Research in disclosure level and compliance with IAS/IFRS began around the year of 2000 and showed a great deal of non-compliance with IAS requirements in various fields (Street *et al.*, 1999). Later studies focus on cross-listed companies seeking to identify significant differences between US listed (and also filing in US) and non-US listed companies. Findings indicate that the overall level of disclosure is greater for companies with US listings (Street and Bryant, 2000; Glaum and Street, 2003).

Unfortunately there is a total dearth of such studies and evidence in Central and Eastern European countries except for those that have been carried out using an international sample, such as Street and Gray (2002)³. Fekete et al (2008) develop a study about Hungarian data and contributes to understanding the level of compliance with IFRS disclosure requirements and its determinants.

Cooke (1989) measured the extent of the information disclosed by 90 Swedish companies (disclosure harmonization). The index was composed of 224 items which we considered should be included in the financial statements. Each item is considered a dichotomous variable; we assigned the value one if the information was provided and zero if not. Weightings were not used, so each item had the same importance. An improvement was done in 2003 by Sánchez (2003) by modifying the Cooke index, to avoid penalizing a company for those items that it need not disclose.

Methodology

1. Measurement tool

To evaluate the disclosure harmonization, in our study we used a disclosure index, as was described and used by Cooke (1989), because through a disclosure index we can provide by a single figure summary indicator the entire content of the report (e.g Ahmed and Courtis, 1999; Coy and Dixon, 2004).

2. Consolidated financial statements Disclosure Index

A major task was to establish which items were going to conform the index, in other words, we sought those aspects that in our opinion, ought to be included in the consolidated financial statements. Being the first study which analyze the disclosure harmony of BVB listed entities concerning the consolidated financial statements, we structured our study in two parts: the first, which is presented in this paper analyze the disclosure of the complete set elements and the second go deeply and analyze the content.

The index is composed by the elements of the complete set of consolidated financial statements and was complemented with an item about the audit report. The Items subchapter shows the 6 items selected, bringing the maximum score to 6. Disclosure index $(DI) = \sum_{i=1, \dots, n} X_i$ where $X = 1$ if the item X_i is disclosed and 0 if not. A set of 6 index score for period 2006-2008 was calculated for each group surveyed. The constructed index is going to allow us to reflect which groups disclose the information of their consolidated financial statements according to the content of the IAS/IFRS, and at the same time, to verify which groups disclose a greater amount of information.

3. Data sources

Data instruments or sources of data which can be used in de facto harmonization studies are mainly of five types: annual reports, accounting regulations, public databases, questionnaires and laboratory techniques. The choice of data source has important repercussions for the overall research design, since there are advantages and difficulties involved with using each of them. We will focus on the two data sources used in the studies shown in table 0, survey data and annual accounts.

The use of annual reports obviously has great advantages, but also difficulties. It does not have the disadvantages mentioned above, but the collection of data is tedious, companies sometimes do not send the financial information and the reports may not be available in a language the researcher can understand.

4. The sample

The Transparency Directive, requires for listed companies annually and semi-annually information for listed companies, so we analyzed the existence and the content of the six sets of consolidated financial statements prepared in accordance with *endorsed* IFRS for the period 2006-2008, in the case of first category listed entities on BVB.

The entities included in the study are those that were listed in the Bucharest Stock Exchange (BSE), the official stock exchange of Romania on the date of balance sheet for financial year 2006, 2007, 2008. We analyzed also individual financial statements and auditor report to see if the entity was obliged or not to prepare consolidated financial statements.

From the total of 21 entities, 7 were excluded from our sample because for them was not mandatory to elaborate consolidated financial statement. The structure of our sample is the follow:

Table 1. Sample description

<u>Number of entities (2006, 2007, 2008)</u>	<u>14</u>
Romanian listed companies :	
- Banks -	3
- Investment funds -	5
- Entities in non-financial sector	6

5. Items

For years 2006, 2007, 2008 we analyzed if the entities obligated to present consolidated financial statements, present the complete set of consolidated financial statements containing:

- consolidated balance,
- the consolidated profit and loss account,
- the consolidated statements of the treasury flows,
- the consolidated statements of the changes in shareholder's equity,
- the group's accounting policies and the explanatory notes.
- the audit report attached o consolidated financial statements

Dichotomy for each item was used. We have opted for conceding the same importance to all the items selected. Lapsley (1992) explains that there is a general agreement among researchers about who the users of the annual accounts are but there are major doubts about the information that satisfies their needs. Consequently, we have not considered any information more important because its depends on the user. In addition, we made no attempt to give additional weight for the quality or quantity of the disclosure.

And for the each element we considered the minimum information required by IFRS. The consolidated balance sheet must present at least the following information, extra to individual balance sheet: financial investments accounted for using the equity method, goodwill, minority interest, presented in the shareholder's equity, issued capital and the reserves allotted to the holders of shareholder's equity of the parent company, group result.

The minimum information that must be presented in the consolidated profit and loss account extra to individual profit and loss account refers to: quota-part in the result of associated enterprises and of associates in participation equated, group result.

The consolidated accounting policies and explanatory notes extra to individually content the follows elements: the consolidation methods, the treatment of the purchasing differences, the conversion methods and the date of account closure; the evaluation methods and rules used for the significant posts in the balance and the consolidated profit and loss account; the consolidation perimeter;

Results

For the period 2006-2008 there were 14 Romanian entities, from the first BVB category which should present annual and interim consolidated financial statements. Just a part of them full fill these requirements as we can see in the follow table:

Table 2. Evolution of CFS disclosure for our sample

Entities	2006		2007		2008	
	INTERM	FINAL	INTERM	FINAL	INTERM	FINAL
TOTAL	14	14	14	14	14	14
SFC	0	5	3	9	4	13
%	0%	35,7%	21,4%	64,3%	28,6%	93%

About the annual CFS there is positive evolution, for instance if we compare 2006 with 2008, in 2006 the number of CFS is limited at 5 but in 2008 the number increase at 13, so only one entity not present CFS. About the interim CFS, the situation is not the same as for annual CFS, due to the less importance gave to interim CFS, by the entities: in 2006 there were nu interim CFS, in 2007 there were 3 interim CFS an in 2008 there were an insignificant increase at a total of 4.

The set of CFS and the audit report for CFS were analyzed, and the Disclosure indexes of CFS for our sample were presented in the follow table:

Table 3. Disclosure indexs of CFS for our sample

Entities	2006		2007		2008	
	INTERM	FINAL	INTERM	FINAL	INTERM	FINAL
A	0	1	1	1	1	1
B	0	0	0	1	0	1
C	0	1	0	0,833	0	0,833
D	0	1	0	1	0	1
E	0	1	0	1	0	1
F	0	0	0	1	0	1
G	0	0	1	1	1	1
H	0	1	1	1	1	1
I	0	0	0	0	1	1
J	0	0	0	0,833	0	0,833
K	0	0	0	0	0	0
L	0	0	0	0	0	0,667
M	0	0	0	0	0	1
N	0	0	0	0	0	0,833

In 2006 the 5 sets of annual CFS were complete, with all elements of CFS and also the audit report for them. In 2007 the number of CFS increase at 9 but the content is less qualitative because there are two entities who present only the consolidated balance sheet, profit and loss account, cash flow statement and own equity movement, without accounting policies and explanatory notes, but joined by the auditor report. In 2008 the evolution is in the same trend like in the previous year, so the number of annual CFS increases at 13 but the quality also decrease, there are 4 CFS which not receive the maximum disclosure index because there are missed parts of the complete set of CFS or are not audited.

Conclusion

There are two important aspects about the CFS disclosed by the Romanian entities from the first BVB category:

- concerning the number of entities which must present CFS, we can conclude that for the analyzed period the number was constant and in time the evolution was good taking into consideration that only after 2007, Romania became an EU member with all obligations concerning the disclosure of financial and nonfinancial information.
- concerning the presented CFS, no significant non-compliance issues were identified during the review of the consolidated financial statements for companies of the sample and none of the audit opinions was qualified. The auditor role is important as we consider that in the auditor report for individual financial statements of previous years, before the presentation of CFS the auditor emphasis the matter about the mandatory CFS presentation.

Generally speaking, we consider that all entities quoted must realize, the adoption of IFRS is an effort to improve company credibility, in our case, the credibility of Romanian companies, particularly those listed on the Bucharest Stock Exchange (BVB).

Bibliography

1. Glaum, M. and Street, D.L. (2003) Compliance with the Disclosure Requirements of Germany's New Market: IAS Versus US GAAP, *Journal of International Financial Management and Accounting*, 14(1), pp. 64-100.
2. Fekete Sz et all - Factors Influencing the Extent of Corporate Compliance with IFRS. The Case of Hungarian Listed Companies, ssrn.com
3. Street, D.L., Gray, S.J., and Bryant, S.M. (1999). Acceptance and Observance of International Accounting Standards: An empirical study of companies claiming to comply with IASs. *The International Journal of Accounting*, 34 (1), pp.11-48.
4. Street, D.L. and Gray, S.J. (2002) Factors influencing the extent of corporate compliance with International Accounting Standards: summary of a research monograph, *Journal of International Accounting, Auditing and Taxation*, 11, pp. 51-76.