

ACCOUNTING PRACTICES FROM FINANCIAL INSTRUMENTS DISCLOSURE PERSPECTIVE – THE CASE OF ROMANIAN BANKING SYSTEM

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International harmonization and convergence of accounting had gradually become one of the most challenging topic of worldwide research and a very hot debated issue in practitioners' sphere, too. Several studies have addressed both formal and material accounting harmonization along time, a wide range of instruments have been developed and various statistical tools have been used in this respect. Basing on this background, we focused our attention on Romanian banking system which is now experiencing a great challenge by finally entirely adopting IFRS after the first step from 2005 when consolidated financial statements in accordance with IFRS were required and the second one from 2009 when informative individual financial statements under IFRS begun compulsory.

Therefore, the objective of our paper is to empirically measure and compare the levels and progress of material accounting harmonization in Romanian banking sector focusing on financial instruments and their related disclosure requirements.

First studies conducted in the measurement of harmonization practices (Nair and Frank, 1981; McKinnon and Janell, 1984; Douppnik and Taylor, 1985) started at the beginning of the 80's, but were merely descriptive, focused on examining how IAS had been adopted in various countries around the world. In the earliest 90's, there were developed the first instruments for measuring material harmonization, namely the concentration indices (H, C and I Index) (Van der Tas, 1988; 1992) and various other forms of these (Archer et al., 1995), which were widely used in various research studies (Herrmann and Thomas, 1995; Aisbitt, 2001; Taplin, 2004).

Basing on these measurement tools and considering the main aim of our study – to measure material accounting harmonization in Romanian banking sector – we stated four hypotheses, thus trying to answer our questions: “Are the accounting practices related to financial instruments disclosure in Romanian banking system harmonized with international requirements? Was there a progress in this respect in the latest years?”

The research methodology used for achieving our goal is based on both static and dynamic analysis using appropriate statistical tools – concentration indices (H or Herfindahl index) for measuring the improvements in financial instruments' disclosure practices, thus pointing out the degree of material harmonization reached step by step as well as the overall progress. In this respect, firstly, we developed a disclosure checklist structured on three sections dealing with financial instruments' general disclosures, derivatives and hedge accounting and risk disclosures.

The results of the performed analysis reveal that accounting practices in Romanian banking sector as regards disclosures related to financial instruments experienced a continuous improvement both at individual and consolidated level, but the level of material harmonization is still relatively moderate. In case of individual financial reporting this can be explained by the recently introduced requirement of preparing financial statements in accordance with IFRS and only for informative purposes. Thus, by now we can talk about a real material harmonization just in case of consolidated financial reporting.

Unlike prior research studies which were focused on similar goals - to measure accounting harmonization around the world, our paper provides a particular approach on a specific business field, the banking one that was not separately explored on this topic before. Thus, we

considered for analysis its related accounting practices focusing on financial instruments disclosure, which is a particular issue, too, thus enriching the research literature on this field.

Keywords: disclosure, financial instruments, IFRS 7, banking, Romania M10, G30

1. Introduction

International harmonization and convergence of accounting had gradually become one of the most challenging topic of worldwide research and a very hot debated issue in practitioners' sphere, too. Several studies have addressed both formal and material accounting harmonization along time, a wide range of instruments have been developed and various statistical tools have been used in this respect, but, anyway it has been argued that the assessment of the extent of measurement harmonization itself is not sufficient to determine the overall level of harmonization of accounting practices.

The aim of our study is to empirically measure and compare the levels and progress of material accounting harmonization in Romanian banking sector focusing on financial instruments and their related disclosure requirements. The reason of choosing financial instruments for assessing the extent of disclosure harmonization derives from the economic sector upon which we focused our analysis, namely the banking one, financial instruments being the most representative in any bank's activity. Thus, our analysis comprises both a horizontal and a vertical study providing an overall image upon the development of accounting practices in banking sector along time, beginning with the year 2009, trying to answer the following questions: *“Are the accounting practices related to financial instruments disclosure in Romanian banking system harmonized with international requirements? Was there a progress in this respect in the latest years?”*

For achieving our goal we selected all credit all credit institutions running their activity in our country, where information needed were made publicly available on their official websites, thus including into our study only 7 banking institutions that prepare and publish their financial statements at consolidated level and 15 banking institutions were individual financial statements in accordance with IFRS requirements were available. The reason of choosing the period 2009-2011 for performing our analysis is based on the National Bank of Romania's decision of requesting informative financial statements in accordance with IFRS for all credit institution. Consequently, if until then we should include in our sample only those banks that prepared consolidated financial statement, thus providing just a partial image about material accounting harmonization, after the year 2009, not only the scope of our analysis became wider, but also the conclusions are more representative, providing a comprehensive image upon the preparedness of Romanian banking system to apply IFRS.

Unlike prior research studies which were focused on similar goals - to measure accounting harmonization around the world, our paper provides a particular approach on a specific business field, the banking one that was not explored on this topic before. Thus, we considered for analysis its related accounting practices focusing on financial instruments disclosure, which is a particular issue, too, thus adding value to research literature on this field.

2. Literature review and hypotheses development

Material harmonization is a research where a wide variety of studies have been conducted along time aiming to examine accounting practices especially within the European Union (EU) and the Association for South-East Asian Nations (ASEAN) (Van der Tas, 1988; Emenyonu and Gray, 1992; Van der Tas, 1992; Archer et al., 1995; Herrmann and Thomas, 1995; Archer et al., 1996; Krisement, 1997), but also in the Nordic countries (Aisbitt, 2001), Japan or Australia (Tarca, 2004).

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In the earliest 90's, there were developed the first instruments for measuring material harmonization, namely the concentration indices (H, C and I Index)(Van der Tas, 1988; Van der Tas, 1992) and various other forms of these (Archer et al., 1995), which were widely used in various research studies (Herrmann and Thomas, 1995; Aisbitt, 2001; Taplin, 2004). As time pass by, new researchers came to enrich accounting literature through comparative analysis of harmonization measurement instruments (Morris and Parker, 1998) or additional tests for measuring the significance of results achieved by using already existing indices (Canibano and Mora, 2000).

Most of these studies aiming to measure material accounting harmonization have been focused almost exclusively on quantifying differences in financial reporting practices between countries, without considering for the analysis any other characteristics of sampled used, namely firms' operating circumstances, such as sector of activity, size, performances or international listing.

Later, applied statistical methods such as: entropy based methodologies (Krisement, 1997) and log linear models (McLeay, et al., 1999; Jaafar and McLeay, 2007) have been used in material harmonization's studies.

Consequently, the results of this studies allows us accepting the tentative conclusion that "rather than a process of convergence, a combination of structural factors at the firm level that demand different accounting treatments and barriers to harmonization at the country level that restrict choice are the likely causes of persistent international differences in accounting" (McLeay, et. al, 1999).

Considering the main aim of our study – measure and compare the levels and progress of material accounting harmonization in Romanian banking sector focusing on financial instruments and their related disclosure requirements – we stated the following hypotheses:

(H1): Accounting practices from financial instruments disclosure perspective are closer to IFRS requirements at consolidated level compared with individual level

(H2): The improvement of accounting practices from financial instruments disclosure perspective in accordance with IFRS was greater at individual level compared with consolidated level

(H3/4)There has been a continuous increasing trend in improving accounting practices from financial instruments disclosure perspective in accordance with IFRS at consolidated level (H3), respectively at individual level (H4)

3. Research methodology

For achieving our goal, firstly we made a list of disclosures required by international regulations dealing with financial instruments, namely IAS 32, IAS 39 and IFRS 7, considering as well the "Disclosure checklist" used by Big Four for assessing the level of applicability of IFRS. The checklist developed ("*Financial instruments related concepts checklist*") comprises a total of 50 items to be disclosed, grouped into three separate sections related to financial instruments' general disclosures (S1), derivatives and hedge accounting (S2), financial instruments' risk concepts (S3), a brief description of these being presented below:

- the first section (S1) mainly refer to *general concepts related to financial instruments*, the accounting policies for these instruments, their main categories of classification, specifications related to reclassifications of financial instruments, reconciliation of the allowance account for credit losses (bad debts), defaults or breaches on loans payable and acceptance of financial assets as pledged or held as collateral;

- the second section (S2) dealing with *derivatives and hedge accounting* mainly refers to the general concept of derivatives and the specific concept of compound financial instruments with multiple embedded derivatives, hedge accounting and its three possible types: fair value hedge, cash flow hedge and hedges of net investments in foreign operations;

- the third section (S3) comprises *disclosures related to risks associated to financial instruments* as the followings: exposure to various risks (credit, market and liquidity risk), concentrations of risk, collateral for risks and various types of analysis related to these risk such as: quality analysis (past due / impaired assets), maturity analysis, sensitivity analysis or "value-at-risk" analysis. For performing the proposed analysis we used appropriate statistical tools (concentration indices), thus, trying to asses the improvements in disclosure practices by reference to international accounting rules. Accordingly, the *research methodology* used, dealing with numbers and based on adopting statistic analysis for drawing our conclusions is a *quantitative* one, while the interpretation of results reached shows its *qualitative* side. Form the temporal criteria, our empirical analysis provides both static and dynamic results, thus describing the progress achieved in disclosure practices related to financial instruments in Romanian banking system for the past three years.

Considering the purpose of our study – to provide a comprehensive overview of the major improvements in financial instruments' disclosure practices in case of Romanian banking sector by pointing out the degree of material harmonization reached step by step as well the overall progress, we chose *H index (Herfindahl index)* for measuring the level of harmony achieved.

The *H index (or Herfindahl index)* is the first indicator developed by Van der Tas (1988) and used in formal accounting harmonization studies, whose values range between 0 and 1. The "0" value reveals a disharmony state, while the "1" value refers to a perfect harmony because all banking institutions in the sample are disclosing the required issues. The degree of *material (de facto) harmonization* will infer to the extent of comparability. Thus, it was pointed out that there is no benchmark for an acceptable level of harmony for the values between "0" and "1" (Emenyonu and Gray; 1992). Consequently, for result interpretation, generally, the larger the value of concentration, the higher the harmonization level achieved.

4. Empirical findings

For accepting or rejecting our hypotheses we proceeded at determining the concentration index both at individual and consolidated level for period analyzed – the years 2009 and 2010. A synthesis of the H (Herfindahl) Index reached by processing data collected using Excel software is presented In Table, followed by an analysis of results reached.

Table 1 Comparison analysis based on H (Herfindahl) Index

LEVEL:	Consolidated			Individual		
	2009	2010	Dif.	2009	2010	Dif.
<i>TOPICS:</i>						
<i>Financial instruments - general disclosures</i>	0.614	0.676	0.062	0.446	0.480	0.034
<i>Derivatives & Hedge accounting</i>	0.532	0.616	0.084	0.274	0.364	0.090
<i>Risk disclosures</i>	0.663	0.678	0.015	0.442	0.486	0.044
<i>TOTAL</i>	0.603	0.657	0.054	0.387	0.443	0.056

Source: own results

Because at the *first stage* of our analysis we proposed to provide just an overall image of Romanian disclosure practices in banking system by reference to IFRS requirements we will focus only on general results achieved on both individual and consolidated level. Thus, as H Index values from the total line of the table reveal we can conclude that even if there is a relatively moderate level of harmonization concerning disclosure practices on both levels, consolidated financial statements provide more disclosures (indices higher than 0,6 on both periods analyzed). Consequently, our first hypothesis (H1) can be accepted. We expected such a result considering that just beginning with the year 2009 all banking institutions were required to prepare their financial statement in accordance with IFRS, too, and only for informative purposes. Thus, their interest in providing the most comprehensive image of their activity was not

their purpose, these sets of financial reporting being just a practice for the real adoption of IFRS beginning with this year. Going further from the static to the dynamic analysis, we expected a greater improvement in case of individual financial statements because these were the newest ones required in accordance with IFRS and usually when you are preparing something from the second time it will certainly be better than the first time. Even if the results achieved are in our consent, thus our second hypothesis (H2) being as well accepted, unfortunately the values did not reached up our expectations, the improvement at individual level (0,056) being just slightly higher than at consolidated one (0,054).

The *second stage* of our analysis goes into details, not only by presenting the results separately for the two considered levels, but also by dividing the accounting practices from financial instruments disclosure perspective into three separate topics according to the sections of the checklist developed for collecting data. When focusing on *consolidated level*, the H index values reveal an increase form one period to another for each of the three topics considered. The highest improvement was recorded in case of disclosures related to derivatives and hedge accounting (0,084), while risk disclosures associated to financial instruments experienced the lowest evolution (0,015). However, transparency on risk information seemed to be the highest one in 2010, H Index reaching the maxim value of all (0,678). Considering the above mentioned issues we appreciate that our third hypothesis (H3) can be accepted. At *individual level*, the results reached are quite similar but on a low scale, considering the lowest level of harmonization in disclosure practices achieved by now due to the newly requirement of preparing financial reporting under IFRS. Thus, while highest improvement was recorded in case of disclosures related to derivatives and hedge accounting (0,090) similar to the above analysis, the lowest evolution appeared to be in case of general disclosures related to financial instruments (0,034). As regards the highest level of transparency ensured by individual financial statements, the values of H Index reached up to 0,486 for risk disclosures. Consequently, we are finally able to accept our last hypothesis (H4), too.

In conclusion, at both levels we identify an improvement in accounting practices related to financial instruments disclosures, which is a good sign for the “real” adoption of IFRS in Romania beginning with the year 2012. However, when looking in depth at the values reached we can assert that there is a relatively moderate level of harmonization in financial instruments’ sphere, so further steps have to be taken for increasing transparency.

5. Conclusions

Accounting harmonization in Romania proved to be a difficult process with major implications in theoretical and practical approach. Banking sector is somehow special in this respect because beginning with this year international standards became mandatory for all credit institutions. Conducting an empirical study in this field is not only a topical issue, but also allowed us enriching the related literature with results from an area that was not explored before in this respect.

Aiming to provide an overall image of material accounting harmonization process in Romanian banking sector for the last years, we focused our attention on issues related to financial instruments appreciating them as “the mirror” of banking activity. Three major topics have been considered for our analysis, comprising items beginning with general disclosures of financial instruments, followed by special disclosures about derivatives and hedge accounting and finally ending with risk information disclosures.

Based on our empirical findings and considering the analysis performed for accepting or rejecting the four research hypotheses formulated, we can conclude that accounting practices in Romanian banking sector as regards disclosures related to financial instruments experienced a continuous improvement both at individual and consolidated level, but the level of material harmonization is still relatively moderate. In case of individual financial reporting this can be explained by the

recently introduced requirement of preparing financial statements in accordance with IFRS and only for informative purposes. Thus, by now we can talk about a real material harmonization just in case of consolidated financial reporting. By briefly analyzing the main topics that followed in our study we can conclude that transparency of risk information seemed to be the highest one at both levels, even if it experienced the lowest evolution of all. Also, we identified the highest improvement in case of disclosures related to derivatives and hedge accounting at both levels, too.

In conclusion, accounting for banking sector followed a positive trend meant to achieve its main goal – the convergence to international standards. By adopting IFRS beginning with the year 2012 for all banks, we can assert that the National Bank of Romania succeeded to take one more step ahead in this respect after the first one from 2005 when consolidated financial statements in accordance with IFRS were required and the second one from 2009 when informative individual financial statements in accordance with IFRS begun compulsory. Anyway, through the conclusions reached, our paper could be considered as valuable for a wide range of users: academics, researchers, practitioners for both public and banking sector.

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