

## IMPACT OF GLOBALIZATION ON FINANCIAL REPORTING

PETRU ȘTEFEA<sup>1</sup>, CARMEN LĂCĂTUȘU<sup>1</sup>

<sup>1</sup> West University of Timisoara, Timisoara, Romania,  
petru.stefea@rectorat.uvt.ro, cornelgabriel.nita@gmail.com

**Abstract:** The future of financial globalisation is one of the biggest questions of our times. How the companies from Romania will align to IFRS requirements and what involves the normalization process in terms of business is an opened subject nowadays. The purpose of this article is to draw into attention the differences on financial terms and the impact of alignment of the current romanian regulations stipulated by OMF 3055/2009 to IFRS. The impact will refer to how will be influenced the decisions of the users of financial information if different regulation apply. In order to quantify the impact of the differences between the accounting treatments, I have made an analysis on Balance Sheet and Profit and Loss statements of the company Alfa. I have presented only the results after mapping the accounts in the Balance Sheet and Profit and Loss forms and interpreted how the decisions of the users of financial information are influenced in both cases. After the analysis performed I have concluded that the decisions of investors, banks and other users of financial statements change due to different results obtained by using the mentioned frameworks. Different approaches conclude to different results, so the purpose of normalization is that the user, wherever he is, takes the same decision based on figures which reflect a fair view of reality.

**Key words:** globalization, financial reporting, financial statements, decisional process

### INTRODUCTION

The recent wave of globalization has generated an intense debate. The potential benefits of financial globalization will likely lead to a more financial interconnected world. The globalization process requires a more powerful information.

Thomas R. Robinson presents in the book called *International Financial Statement Analysis* the constraints regarding the information supplied by financial statements:

- The need to have the desired characteristics; for example, to be relevant, information must be provided on time. This requires considerable time to obtain assurance that the information is free from errors;
- Cost of providing the information: benefit derived from information should exceed the cost of providing them;
- Omissions of financial statements: the financial statements omit non-quantifiable information (creativity, innovation, workforce competence of a company, which are not directly presented in the financial statements). (Robinson Th., Greuning H., Henry E., Broihahn M, 2008)

These constraints are generated by a number of obstacles, among which we can mention:

- The conflict which exist sometimes between the qualities required to accounting information by various categories of users around the world;
- Difficulties in selecting the information considered to be significant and relevant by various categories of users at international level;
- Difficulties in evaluating the “benefit” which will be generated by the information;
- Frequent updates in financial reporting framework, which adversely affect the comparability of the information presented at international level. (Cotleț D., Megan O., Pistol I., 2007)

The accounting system of a country is the product of a complex process. During this process rules and accounting practices are developed as a result of interaction between makers and users of financial statements.

The different needs of various users of accounting information resulted in the construction of two representations of the same reality about a company: a representation to satisfy information needs of external users (investors, creditors, statutory authorities, customers, trade unions) and a representation to satisfy information needs of internal users (managers, who plan, organize and manage a business, marketing managers, production supervisors, finance directors). (Kimmel P., Kieso D., Weygandt J., 2011)

The financial information is currently dominated by globalisation, by the techniques related to the consolidation of accounts, which are improved all the time and also by the development of some concepts as “eco” accounting, inflation adjusted accounting. The assimilation of IFRS regulations in continental-european countries can be considered a difficult process, which needs time. In order to align to IFRS rules, in Romania will have to be assimilated an accounting referential oriented to financial communication, the professional judgement playing an important role.

## OVERVIEW

The general accounting framework in Romania is represented by the Accounting Law no. 82/1991.

Under the Accounting Law, Romanian companies and permanent establishments in Romania of foreign companies are required to organise and conduct their own accounting, including preparation of annual financial statements (exemption is given to branches of EU countries). Romanian companies and foreign entities doing business in Romania through permanent establishments must apply the accounting regulations depending on the nature of their business.

The trading companies apply the Accounting Regulations compliant with Fourth and Seventh European Directives, approved by the Order of Ministry of Public Finance of Romania no. 3055/2009 (“OMF 3055”).

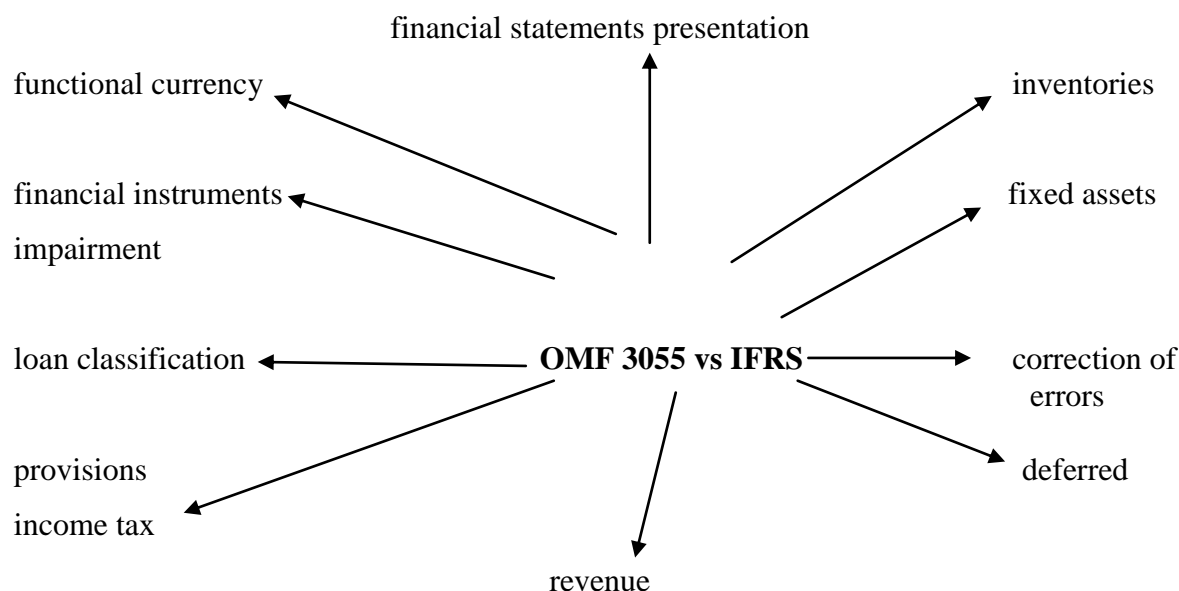
3055 distinguishes the companies that should prepare simplified financial statements from the companies that should prepare “complete” financial statements based on three size-criteria:

- total assets – EUR 3,650,000,
- annual net turnover – EUR 7,300,000, and
- average number of employees during the financial year – 50.

If a company exceeds at its balance sheet date the limits of two of the three criteria in two consecutive years it must prepare a full set of financial statements comprising balance sheet, profit and loss account, statement on changes in equity, cash flow statement, and explanatory notes to the financial statements.

Otherwise, it shall prepare simplified annual financial statements comprising simplified balance sheet, profit and loss account and explanatory notes to the financial statements. The company can also opt for preparing a statement on changes in equity and/or of cash flow statement.

I have summarized below the main differences, in terms of financial accounting, between OMF 3055/2009 and IFRS regulations.



Source: author

## DIFFERENCES BETWEEN ROMANIAN GAAP AND INTERNATIONAL FINANCIAL REPORTING STANDARDS

### Financial statements

The Romanian Accounting Regulations prescribe the format of Balance sheet and Income Statement (different from IAS 1)

### Inventories

Methods permitted to determine cost: FIFO, weighted average cost or LIFO (LIFO is not allowed in IFRS).

Allocation of price differences to the value of inventories can be made based on a coefficient (different from IAS 2).

Discounts received from suppliers after the issuance of invoice for inventories do not adjust inventories and are recorded directly in profit or loss.

### Property, plant and equipment

In the first year of application of Order 3055 (or the previous Order 1752/2005), the residual value from the beginning of the year can be treated as purchase price, in the cases where the purchase price cannot be determined without expenses or significant delays (concept similar to deemed cost under IFRS1).

.Capitalisation of interest is an accounting policy choice (unlike IFRS, where it is mandatory under IAS23)

For idle fixed assets – policy choice between continue to depreciate or stop depreciation and record a provision (under IFRS always continue to depreciate).

Revaluation reserve: treatment for tax purposes of the revaluation reserve must be disclosed in the explanatory notes.

### **Impairment of property, plant and equipment**

Impairment is assessed as the difference between stock-count value (determined at the yearly stock-count) and carrying value at each balance sheet date. Stock-count value should be determined considering the asset's utility, condition and market price or by using other valuation methods (such as discounted cash-flows). Impairment indicators may be considered when assessing if there is impairment. (Different than IFRS - impairment test done only if there are impairment indicators, clear guidance on how to determine impairment).

### **Intangible assets**

Capitalization of start-up expenses is permitted (these are recognised as expenditure in IFRS).

Customer lists cannot be recognised as assets, not even in business combinations (IFRS – allowed in a business combination).

Concessions received are reflected as intangible assets when the concession contract establishes a duration and value determined for concession. Amortization of concession is to be recorded over the period of use, established in accordance with the contract. In case the contract provides for rent payment, instead of a depreciable value, the accounting records of the company receiving the concession reflect the rent expense, without recognition of an intangible asset (not consistent with IAS 38 – legal form over economic substance).

Business combinations: no guidance on identifying additional intangible assets.

Amortization of goodwill over a period of maximum 5 years or longer, with explanations in the notes (in IFRS 3 it is not amortised, but tested for impairment at least annually).

Revaluation of intangible assets is not permitted.

### **Correction of errors**

Correction of errors related to previous periods is made by adjusting retained earnings, but it is not allowed to restate comparative (under IFRS comparatives must be restated).

If the correction of errors results in accounting loss, this loss should be covered before any distribution of profit.

### **Deferred income tax**

No standard exists under Romanian GAAP.

### **Revenue recognition**

No detailed standard on revenue recognition; revenue is generally recognised when risks and rewards are transferred.

Construction contracts – revenue only recognised if the works are accepted by the clients (signed reception minutes or other documents).

Loyalty programmes – impact is recognised as a provision and expense (IFRS: deferred revenue and decrease of revenue).

### **Functional currency**

Reporting and presentation currency is RON.

### **Hyperinflationary economy**

No standard exists.

Romania was hyperinflationary up to 31 December 2003, therefore, under IFRS, all non current items (e.g. property, plant and equipment, share capital etc) should be restated in terms of purchasing power existed as at 31 December 2003. Under Romanian GAAP revaluations could have been done that could, in certain circumstances, result in similar results to hyperinflation accounting.

### **Earnings per share**

No standard exists.

### **Provisions**

The conditions for recognising are similar to IFRS.

### **Long-term/short-term classification**

The requirement in IAS1 that results in the classification of loans as short-term if the borrower can demand repayment within 12 months does not exist.

### **Financial instruments**

Valuation at fair value only allowed in the consolidated financial statements, as follows:

- In case of valuation of financial instruments at fair value, change of value is included in the Income Statement.
- However, such a modification is not included directly in the shareholders' equity, in a fair value reserve, if:
  - a) the instrument accounted for is a hedging instrument in accordance with an accounting hedging system which allows that certain or all value modifications should not be recorded in the Income Statement; or
  - b) the value of the modification refers to a foreign currency exchange rate difference arising for a monetary item which is part of a net investment of the company in a foreign entity (Net investment in a foreign entity as per OMF 1752 means the share of the reporting entity in the net assets of the respective foreign company).
- Modification of the value of an available-for-sale financial asset, other than a derivative financial instrument, may be included directly in the shareholders' equity, in the fair value reserve.

For the standalone financial statements only short-term quoted instruments should be valued at market price.

Free shares – they are recorded either in reserves for long-term investments or in the income statement for short-term ones.

Bank deposits are short-term investments (not cash).

### **Disclosures**

Significantly less disclosure requirements under OMF 3055/2009.

According to the IFRS standards, assets are ranked in the balance sheet in descending order and liabilities in ascending order. Synthetically, these differences can be seen in table no. 1.

**Table 1**

**Comparative structure of the balance-sheet assets and liabilities**

In compliance with national laws (accounting regulations consistent with European directives)		In compliance with IFRS standards		Adjustments	Comment
A. Fixed Assets		Non-current assets			
I. Intangible assets	28.00	Property, plant and equipment	155.00	2.00	Interest 0.5 could be capitalized on IFRS; 1.5 difference restatement due to revaluation concession-rent expense under IFRS deferred income tax asset only under IFRS
II. Tangible assets	153.00				
III. Financial assets	0.00		26.00		
		Intangible assets	0.02	-2	
		Deferred income tax assets	17.00	-0.02	
		Available-for-sale financial assets	0.00		
		Trade and other receivables			
		Current assets	23.00		
		Inventories	19.00		
		Trade and other receivables			
B. Current assets					17 EUR are assets held to be sold; 1 EUR commercial discounts from suppliers
I. Inventories	41.00		1.00		
II. Receivables	19.00	Available-for-sale financial assets			
III. Short-term investments	1.00	Financial assets at fair value through profit or loss	0.00		
IV. Cash and bank accounts	3.30	Cash and cash equivalents (excluding overdraft)	3.30		
C. Prepaid expenses	0.00				
<b>Total assets</b>	<b>245.20</b>	<b>Total assets</b>	<b>244.32</b>	<b>-0.02</b>	

D. Debts: amounts payable within one year		Equity			
		Ordinary shares	25.00		
		Share premium	17.00		
		Other reserves	10.30	0.7	eliminate 2011 revaluation reserve
	16.50	Foreign currency translation reserve			
		Retained earnings	56.02	1.3	0.7 adjustment depreciation due to revaluation interest 0.5
G. Debts: amounts payable within more than one year	119.50	Non-current liabilities	115.50		
		Borrowings			
		Deferred income tax liabilities	0.00		
		Retirement benefit obligations	4.00		
		Provisions for other liabilities and charges	1.00		
		Current liabilities			
		Trade and other payables	0.00	-2.00	concession adjustment
		Current income tax liabilities	0.50		
		Borrowings	14.00		
		Provisions for other liabilities and charges			
H. Provisions	2.00		1.00		
I. Deferred income	0.00				
J. Capital and reserves					
I. Subscribed capital (presenting separately the paidup and unpaid capital)	25.00				
II. Share premiums	17.00				
III. Revaluation reserves	0.70				
IV. Reserves	10.30				
V. Profit/loss carried forward				-0.02	deferred tax asset impact
VI. Profit/loss of the financial year	54.20				
Total equity and liabilities	245.20	Total equity and liabilities	244.32	-0.02	
Check Total assets=Total equity+liabilities	yes		yes		

There are some differences between the accounting treatments, reflected in the Balance Sheet statement:

*The company has received commercial discounts from suppliers.*

As per IAS 2 “Inventories” there is no difference between the various types of price discounts, all reducing the acquisition cost. As we can see, the balance of “Inventories” at year end under IFRS is EUR 23,000. OMF 3055 treatment is different depending on the nature of the discounts (commercial or financial) and also depending on their issue moment: when the initial invoice is provided or when the subsequent invoice is issued. The financial discounts are not deducted from the acquisition cost, they are recognized as “Financial discounts” (account 767). The commercial discounts included on invoices subsequently issued adjust the operational expenses (account 609). No adjustment on Balance Sheet statement has been made on OMF figures due to the commercial discount received. Only the Profit and Loss figures are impacted.

The company has closed a contract with the Local Authorities in respect of a *concession* in amount of EUR 200,000. The contract specifies the total depreciable value and not a monthly rent to be paid. As per OMF 3055, the concession in amount of EUR 200,000 has to be recorded as intangible asset. The accounting treatment under IFRS is different: the concession will be recorded as a rent expense in Profit and Loss account.

The company is building a new plant. The As per IAS 23, the *borrowing costs* directly attributable to the acquisition, construction or production of assets that take a substantial period of time to be used or sold must be capitalized.

The company has *revaluated* the fixed assets during 2011. Under IFRS, all non current items (e.g. property, plant and equipment, share capital etc) should be restated in terms of purchasing power existed as at 31 December 2003. The revaluation has been made for all fixed assets, for some generating surplus and for other loss. We have restated the IFRS figures, eliminated the revaluation reserve effect of EUR 700 and also the impact on the fixed assets value, including also the impact on depreciation of EUR 1,300.

IFRS requires the *capitalization of interest* in amount of EUR 500. For OMF purposes the interest has been recorded in Profit and Loss account.

OMF 3055 does not allow the recognition of *deferred tax*. We have computed the adjustment by applying the rate of tax of 16% to the fixed assets value restated.

The company has *financial assets held with the purpose to be sold*. As per IFRS 5, the value of these assets will be recovered by selling them rather than by using them. These assets stops to be depreciated and are valued at the lower value than cost and fair value less cession costs, by affecting the Profit and Loss with the impairment value, if the case. OMF 3055/2009 does not recognise this category of assets, they are transferred from fixed assets to inventory, if a fixed asset is improved in order to be sold.

In compliance with the national laws, the profit and loss account includes all revenues and expenses of the year, grouped by their nature, arranged alternately (revenue, then expenses within each activity, establishing the earnings per each activity), and the profit or loss for the period. IAS 1, ‘Presentation of financial statements’, and other requirements that impact the income statement/statement of comprehensive income. Entities have a choice of presenting all items of income and expense recognized in a period either:

- (a) in a single statement of comprehensive income; or
- (b) in two statements (as adopted by IFRS GAAP plc) comprising:
  - (i) a separate income statement, which displays components of profit or loss; and
  - (ii) a statement of comprehensive income, which begins with profit or loss and displays components of other comprehensive income.

The main difference between these two options is that in option (a), profit for the year is shown as a sub-total rather than the ‘bottom line’, and the statement continues down to total comprehensive income for the year.

Synthetically, these differences can be seen in table no. 2.

**Table 2**

**Comparative structure of the profit and loss account**

In compliance with national laws (accounting regulations consistent with European directives)		In compliance with IFRS standards		Comment
1 Net turnover	300.00	Revenue	300.00	
2. Changes in inventories of finished goods and work in progress	0.00	Other income	5.00	
3. Production made by the entity for its own purposes and capitalized	0.00	Purchase of goods for resale		
4. Other operating income	5.00	Purchase of external services	40.00	
5. a) Raw materials and consumables	170.00	Utilities expenses	0.3	
b) Other external costs		Rent expenses	0.5	concession-rent
Commercial discounts received from suppliers	-1.00	Insurance	0.2	
6. Staff costs:	20.00	Telecommunication services	0.1	
a) Salaries and grants		Promotion, marketing and advertising	0.2	
b) Social security costs with a separate indication of those relating to pensions		Travel	0.1	
7. a) Value adjustments in respect of tangible and intangible assets	23.00	Repairs	0.3	commercial discounts
b) Value adjustments in respect of current assets, to the extent that they exceed the amount of value adjustments which are normal in the undertaking concerned		Personnel costs	20	reduce the inventory costs on IFRS
8. Other operating expenses	41.30	Purchase of materials	170	
		Depreciation and amortization expense	23	
		Other expenses	0.1	
		Capitalized internal construction costs		
Operating profit or loss	51.70			
		Operating profit before financing costs	50.3	
9. Income from participating interests, with separate indication of that derived from affiliated undertakings		Financial income	30.00	
10. Income from other investments and loans forming part of the fixed assets, with a separate indication of that derived from affiliated undertakings	30.00	Financial expenses	13.60	
11. Other interest receivable and similar income, with a separate indication of that derived from affiliated undertakings				
12. Value adjustments of financial assets and investments				

held as current assets	13.60			
13. Interest payable and similar charges, with a separate indication of that regarding affiliated undertakings				
Financial profit or loss	16.40	Net financing position	16.40	
14. Profit or loss on ordinary activities	68.10	Profit/loss before tax	66.70	
15. Extraordinary income	0.00			
16. Extraordinary expenses	0.00			
17. Profit or loss on extraordinary activities	0.00			
18. Tax on profit	10.89	Income tax expense	10.67	
19. Other taxes not listed at the items above				
20. Net profit/loss of the financial year	57.21	Net profit for the year	56.02	
		Other comprehensive income		
		Foreign currency translation	0.00	
		Comprehensive income for the period	56.02	

### CONCLUSIONS

The differences between the above frameworks concern quality and substance.

As it can be seen above, the different approach under IFRS and OMF 3055 has impact on the Balance Sheet and Profit and Loss Statements figures. Only looking at the profit, if OMF regulations are applied, the indicator is higher than using IFRS judgements. Also the impact of tax should be taken into consideration.

The decisions of the users of financial statements could be influenced, for eg. on computation of financial indicators. Shareholders could evaluate the management work depending on profit figure or other financial indicators, investors could decide to buy or not shares, banks make their own analysis in order to finance or not the companies with loans, local authorities benefit of more or less taxes encashed, suppliers continue to provide the necessary materials if the relationship developed is a reliable one.

So, the accounting treatment has impact on the strategy and the future of the company. The question is what accounting treatment better reflect the reality, in order that the users of financial information take the best decisions, based on fair and reliable information.

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