ADOPTING THE INTERNATIONAL FINANCIAL REPORTING STANDARDS AT EUROPEAN LEVEL: DIFICULTIES AND CONSEQUENCES[1]

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Abstract:
Under the circumstances of the expansion and development of capital markets of multinational companies, the need for complex and high quality financial information became clear. Adopting international financial reporting standards at European level has been decided to provide a guarantee for the high degree of transparency and comparability of financial statements and a well-functioning financial markets community. The main objective of this study is to identify and explain the difficulties of adopting IFRS, given the fact that the European Union represents a specific context where most countries have a tradition quite different from traditional accounts that lay at the foundation of the international body. The paper also aims to analyze the consequences of IFRS adoption in Europe, regarded as one of the most significant changes in financial reporting in recent years and even a true "cultural revolution".

Key words: *IFRS, adoption, UE, conformity, comparability*

JEL classification: *M41*

1. Introduction

Adopting IFRSs in Europe is one of the most important steps in achieving international accounting convergence. Probably there will be nothing more important related to international accounting convergence than the European Union decision to adopt IFRSs (Jermakowicz şi Gornik-Tomaszewski, 2006). This decision came in the context of the need for transparency and comparability in financial reporting, strenghten by the continue expansion of EU and the adoption of EU Constitution.

The stated objective of the EU decision is that of seeking a high level of transparency and comparability of financial statements and a well-functioning capital market in the Community. The aim of this paper is to study the extent to which the EU proposed target can be achieved, given the difficulties affecting the implementation of IFRSs in member states. In this regard we present the IFRSs adoption mechanism in EU and analyze issues related to achieving compliance with international standards, especially in the context in which they are considered as Anglo-Saxon oriented while accounting in most of European countries is based on Continental European model.

In order to achieve the intended purpose, we use fundamental research consisting in literature review of the IFRSs adoption barriers in Europe and the consequences of such a decision. The study indicates the existence of differences

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between IFRSs adopted by the EU and full IFRS, which may affect the comparability of financial statements.

1. Adopting international financial reporting standards in Europe

In the conditions under which Member States have proved to be incapable of agreeing on an European accounting harmony, they have decided to align the accounting standards after those issued by a private international body, the IASB (Revault, 2009). Although at that time there were numerous reactions of indignation against the adoption of rules issued by an uncontrollable body, implementing international standards at European level has become reality.

By the decision of the European Union (EU) regarding the enactment of regulation of the European Parliament and Council on the application of International Accounting Standards no.1606/2002 (The IAS Regulation or IFRS 2005), the member states listed companies, including banks and insurance companies are obliged to prepare consolidated financial statements in accordance with international standards as adopted by the EU from 1 January 2005. Considered as "an accounting revolution", the adoption of international referential by the EU is the result of a "strategic option", which even if it involves some time and resource constraints, contributes to achieving convergence. By this decision, Europe adopts a new accounting language based on general principles rather than on detailed rules and which emphasises the analysis of the substance of the operations and events (Bunea, 2006). However, not all countries go with the same speed on the road to convergence with international accounting referential. These countries need time, so that businesses are prepared to move from national to international standards.

Nobes and Parker (2008) draw attention to the importance of the distinction between the adoption of IFRS and convergence with IFRS. At the judicial level, the adoption means giving up national rules and replace them with IFRS requirements. An example of this is the mandatory situation of EU listed companies for the consolidated financial statements. Besides adoption, countries may decide to gradually alter the meaning of national accounting rules for the approach to IFRS, for some or all accounting objectives. This process can be called convergence. An interesting example of convergence is that of Australia, where international standards have been converted to national standards since 2005. However, the Australian version contains additional paragraphs and even standards, while some original paragraphs were deleted. Australian process seems to be very close to convergence with IFRS rather than exact adopt of the IFRS. The authors consider that it must be admitted however that "if the situation in Australia is not just adoption, it is not the case even in Europe, due to approval issues."

The process by which the adoption of IFRSs in the EU is made is a complicated one, with a strong political influence. For this purpose, a mechanism has been conceived with the main function of supervising the adoption of new rules and interpretations, but also to ensure compliance with European directives (Bunea, 2006). An international accounting standard cannot be adopted in Europe unless that standard is the subject to the adoption and meets all the following conditions: it is not contrary to the principle of true and fair view of the 4th and 7th set out Directives; responds to the European public interest; meets criteria of intelligibility, relevance, reliability and comparability required by financial information needed for economic decision; upgraded European accounting directives[2] will remain in force and all companies will be obliged to refer to them (Feleaga, 2006). Beyond their role in the mechanism of adoption of IFRSs, European directives should ensure equality between enterprises that do not apply IFRS standards

[2] To meet the international referential and to eliminate potential incompatibilities with current and future IFRS standards, the Accounting Directives have been revised (in some limited areas, current prescriptions of these directives have remained inconsistent with IFRS).

and those who apply them (this uniformity will also help any contingent transitions, for example the case of a company which is seeking admission to a regulated financial market).

Implementation mechanism has two components: a technical and a political one. The technical part is provided by a technical committee of the European Financial Reporting Advisory Group - EFRAG, consisting of a group of experts from the accounting profession, standardization bodies, users, regulatory bodies and market surveillance and has the power to provide EU assistance and expertise needed to assess the IFRS standards, expressing his opinion regarding their compliance with European directives and their implementation in Europe. Since the European Commission (EC) has full confidence in the impartiality of evaluations EFRAG, in July 2006 was constituted the body called Standards Advice Review Group-SARG, and as members representatives of independent auditors and national standard setters, with the role to review the EFRAG views and to provide an assurance of objectivity.

The political component is supported by Accounting Regulation Committee - ARC composed by representatives of all member states and chaired by the EC, with the aim to develop opinions on standards adopted by the EU, to establish the date of entry into force of rules[3] and to state the last frame of the EU standards, revisions and interpretations issued by IASB. The commission must inform the ARC, at the right time, of its intention not to propose the adoption of a standard.

Following evaluation of the assurance given by EFRAG and SARG, the EC proposes the standard to European Parliament and ARC. This is the "political phase of the adoption of IFRS in the EU". In the circumstances when the international standard application is approved, the EC decides on its application and interpretation accepted in the EU official, and next to be published in the EU Official Journal in all official EU languages (Ionaşcu & Ionaşcu, 2008). Tracking is performed by applying IFRS Committee of European Securities Regulators - CESR. CESR is an independent body composed of representatives of regulatory authorities in different Member States, founded in 2001 by the EC.

Through this mechanism, agreeing to IFRS, Europe assumes the means to pressure, if necessary, the international body, where a standard would not sufficiently protect European interests.

Nobes & Parker (2008) argue that despite the adoption or "alleged adoption of IFRSs" differences may appear between IFRSs in force at a particular time and the EU adopted IFRSs. In addition, the adoption of the EU can take several months, so some parts of IFRSs may be effective but not approved before the end of the year. EU companies may be required not to comply, unless they are in line with EU approved IFRS. A role in this respect is held by the remarkable dynamics that characterize IFRSs due to both its own development and the emergence of IFRS as a variant for international convergence.

Therefore, in most European countries has been requested to stop the continuous change in IFRSs, arguing that "no accounting system is not perfect and all are infinitely variable". Parliament recommends the EC to assess the outcome of the first year implementation of IFRSs, affirming the need for a regulatory pause and consistent application of standards (Ristea et al., 2006).

In our opinion, the constant and consistent change of the international standards issued by IASB and the European presence of a complex mechanism of their adoption generates differences between IFRS adopted by the EU and the full IFRS. Nobes &

[3] ARC has decided to take all international rules and interpretations, except IAS 32 and IAS 39 rules. Financial services companies have been arguing against the level of volatility.

Parker (2008) consider that this has created confusion and generated problems to the auditors. It seems clear, however, that mandatory use of IFRSs for consolidated accounts of listed companies can lead to end the development of national standards in some countries.

3. Consequences of applying international referential to Europe

The application of IFRSs in Europe cannot be reduced to a simple accounting problem, which can be solved by eliminating some significant differences. The transition to international referential is a true "cultural revolution" which involves all groups of society functions (general management, financial management, financial communication, management control, information systems, human resources, training). This decision brings fundamental changes in the area of European accounting professionals reflection. Disruption is even greater as some European countries (the majority) carried and still are carry of an accounting model philosophy away from Anglo-Saxon model which is inspired by the work of the IASB (Feleaga & Feleaga, 2006). It is these accounting differences between the two cultures (Anglo-Saxon and continental European) may cause difficulties in applying IFRSs in the EU and may even lead to the preservation of indigenous elements in the accounts of countries that do not identify with the Anglo-Saxon culture.

To understand these differences and to explain how it affects the implementation of IFRSs in Europe, the two accounting models must be weighed.

Continental European accounting model was influenced by Roman law system, which had legislation as the main source. In civil or commercial law was necessary to lay down rules on accounting and financial reporting (Nobes and Parker, 2008). In Roman law system countries, the interference between the existing legal system and accounting system is more pronounced, and could establish the existence of legal terminology in the accounts (e.g., defining elements of financial statements is done by reference to the legal concept of wealth) (Ristea et al. , 2006).

Continental European model is characterized by increased financial reporting compliance with tax law, creditor protection and conservatism (Jermakowicz and Górnik-Tomaszewski, 2006). It is oriented towards the interests of banks and state, accounting rules were issued following a legislative process (Ionaşcu, 2003).

Anglo-Saxon accounting model is correlated with the customary law system, based on experience and on "local custom"[4]. In the common law, judges issue principles from which the right is assigned, a key role being attributed to previous doctrine. A court must apply the rule of law used in similar cases by the higher courts, and in some cases the rule of law it-itself applied in previous cases (Ristea et al., 2006).

This model is geared towards the interests of shareholders information, disconnected by taxation and regulated, generally, by liberal accounting profession (Ionaşcu, 2003). Countries in this category are less conservative (Callao Gastón et al., 2010) and are considered to have a better accounting system and better protection of investors (La Porta et al., 1998 cited by Soderstrom and Sun, 2007).

Adopting IFRSs for consolidated financial statements of listed companies in a market in the EU brings into question of compatibility between the legal system of most European countries and the customary law underlying IFRSs. Financial markets in Europe are very different in terms of development, and the incentives of managers and authorities for standard imposing and control compliance are formed locally.

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[4] In England, today, customary law (common law or case law) form only part of the general law, which is predominantly legal right, that is, laws issued by Parliament (Statute Law).

The literature contains many researches that addresses the issue of IFRSs adoption in Europe. Their application is made differently, being influenced by factors such as economic, social, culture and the profession, type of industry, difficulties in enforcement. Given that international rules are regarded as being centered on Anglo-Saxon culture, their implementation in continental European countries might encounter difficulties because of the accounting differences between the two cultures.

A widely discussed issue in the world and especially in EU countries, is on determining the level of compliance with IFRSs. Studies in the implementation of IFRSs have shown lack of compliance with the requirements of international standards in various aspects (Gîrbină & Bunea, 2009).

Street and Gray (2002) examined the financial statements and footnotes of a sample of companies worldwide to assess the degree of compliance with IFRSs and found a significant number of cases of non-compliance, especially in the disclosure requirements. Compliance was very problematic in some western European countries (e.g. France and Germany), one explanation offered by the authors aimed at issues of familiarity, because the accounting systems of continental Europe differs from the Anglo-American approach based on IFRS.

Larson and Street (2004) found that although many large companies around the world claim that the present financial statements are in accordance with IFRSs, the reality is different. Studies have reported that there are significant differences with IFRSs.

Schipper (2005, cited by Albu et al., 2010) revealed differences in the implementation of IFRSs in EU countries as „all jurisdictions will adopt the same standards, but the institutional rules that have generated incentives for financial reporting vary, sometimes significantly between jurisdictions. In such circumstances, there are differences between national standards and IFRS on the one hand and between the different ways in which accounting rules are used, on the other .

Delvaille et.al (2005) compared the developments in France, Germany and Italy, and the approaches used in the integration process of European IFRS accounting reform. The authors conducted an empirical study on the use of IFRSs by companies listed on three stock markets. The results clearly show that the use of IFRSs is most widespread in Germany. They concluded that although, over time, it was considered that France, Germany and Italy in the past have used the continental European system of accounting, they are very different today, not only in reporting practices, but also how they were adapted to IFRS.

Jermakowicz & Górnik-Tomaszewski (2006) examines the impact of adopting international standards on the financial statements. For some EU countries like France and Germany, where national standards differ than IFRSs, this change is expected to be relatively more beneficial for investors in these countries and have a significant impact on financial results. The authors investigate how European companies perceive the benefits and challenges of implementing IFRSs, arguing that the understanding of such issues would be helpful to all categories of users of financial statements, including regulatory authorities which should take decisions related to individual accounts and unlisted companies. The authors analyze the implementation of IFRSs by European companies. Based on 112 responses received, it concludes that the implementation of IFRSs, companies are not expected to reduce capital costs, but expect increased volatility in financial results. Many respondents tend to agree with the benefits and costs of transition. The majority of companies said they would not adopt IFRSs if not bound by EU regulation.

Alexander & Segura (2010) investigate the influence of recent developments concerning the extension of IFRSs and cultural specificity in the French context. The authors argue that the fundamental difficulties arising from the introduction of IFRSs in

the French national requirements (General Accounting Plan) have been inevitable, predictable and self-imposed.

A direct consequence of the decision of adoption the IFRSs by EU in the member countries is the concomitant use of two sets of accounting standards: both international and national. In the study by Larson and Street (2004), companies express concern about the emergence of a"double standards" system, under which the EU Member States listed companies will adopt IFRSs in the consolidated accounts, and other companies will continue to prepare financial statements in accordance with national accounting standards and warns of the consequences those countries may experience if they do not take action to adopt IFRSs. The findings provide evidence that the IASB is regarded as an appropriate body to „develop a global accounting language, thus supporting the legitimacy of the international body".

For Jermakowicz and Gornik-Tomaszewski (2006), the fundamental question the authors seek an answer is about the future of European accounting. The IAS Regulation requires the adoption of IFRSs for consolidated financial statements only. Therefore, this regulation increases the gap between them and separate financial statements, introducing a distinction between listed companies and others. However, EU Member States have the ability to authorize or make mandatory use of IFRSs in the consolidated accounts of not listed companies and even the development of individual financial statements of companies listed or unlisted.

Most countries allow at least the use of IFRSs for individual financial statements for listed companies. This policy was expected in common law countries with investor-oriented accounting systems, such as Great Britain or Ireland, where national standards are based on the same principles and serve the same goals as IFRSs. Moreover, these countries take sustained action to achieve convergence of national standards with international ones. It is noteworthy that the courageous decision of some countries Cyprus, Estonia, Latvia, Slovakia, Slovenia, Lithuania, Malta, which joined the EU relatively recently, in 2004 and even Bulgaria - with the exception of SMEs, new EU member, to compel IFRSs implementation in the individual accounts of listed companies. Nobes & Parker (2008) explain such a decision by the lack of well developing their own accounting rules.

On the other hand, a significant number of countries belonging to the continental European model, such as Austria, Belgium, France, Germany[5] prohibit the application of IFRSs financial statements. Nobes (1998) explains this by the fact that the distinct statutory target of individual financial statements in these countries is to protect the creditors and the state.

Ionaşcu and Ionaşcu (2008) believe that companies in Europe that draw up and publish two sets of financial statements: one as European directives and other issued by IFRS, will have problems in the flow of accounting information and additional costs. According to the IASB, making multiple sets of financial statements by the same company for different categories of users, is not a viable solution because it leads to additional costs for both the entity that produces, as well as for users who need to be adequately prepared in order to distinguish different types of provided accounting information.

However, most EU countries have responded positively to IFRSs implementation at national level. Thus, in addition to mandatory consolidated financial statements of listed companies, EU countries have benefited from the options offered by the IAS Regulation and chose either to force (a smaller number of countries) or allow (a significant number of countries) the application of international standards for other

[5] Yet in this country are allowed to prepare IFRS financial statements for information only.

categories of companies. Our opinion is that it remains to be seen whether these countries manage to overcome the differences between national and international standards and various difficulties related to the effective implementation of international norms in order to achieve the desired comparability.

4. Conclusions

Europe created in the application of international referential „a new IFRS framework: legal, political and controlled" through modernizing the directives in order to remain the main issue in the EU financial information and to allow full comparability with IFRS. To create an European mechanism for the adoption of international standards to ensure consistent and rigorous application of them, Europe managed to better protect its interests, creating a control to monitor the application of IFRS by European companies (Feleagă & Feleagă, 2006).

Although recent studies have shown that national accounting standards are gradually converging with international ones, especially at European level, a significant number of gaps remain in question. In my view, the process of adopting IFRSs at European level is affected by the existence of the gap between the issuance or revision of international standards and its adoption in Europe and the extent to which IFRSs have been amended following the adoption process. To these are added the presence of many differences between member countries, which also involves high costs for their disposal. Another major obstacle is the strong relationship existing between accounting and taxation, manifested mainly in continental European countries. In this case, is more difficult for EU countries to abandon tradition to prepare financial statements in accordance with tax rules for international financial reporting standards.

EU represents a specific context where most countries have a long tradition based on Roman law, very different from the one founded on common law tradition held by most countries involved in setting the original cultural specificity of the IASB. In addition, most of the economies in the EU have a limited history regarding the capital markets as sources of major funding and a tradition of corporate financial reporting requirements aimed at companies that are not listed. Therefore, „juxtaposition of IFRSs and the traditions EU is likely to involve differences in attitude and expectation and thus a potential of involved difficulties, mutual suspicion and uncertainty"(Alexander & Eberhartinger, 2010).

We believe that despite the large impact of IFRSs application in Europe, problems still remains related to achieving conformity and thus expected comparability of financial statements and the viability of having two different accounting systems. In this context it must be also identified the extent to which the convergence of standards for all companies or just for the listed one is required.

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