

# IMPLEMENTING IFRS IN THE BANKING SYSTEM

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## **Abstract:**

*The use of IFRS in the banking system improves transparency and comparability of accounts for investors and other stakeholders, and consequently can have a positive impact through improving access to capital and funding. Also, greater transparency and comparability of reporting is the way to go in the aftermath of the crisis.*

*The UK is strongly of the view that Europe should use IFRS as published by the International Accounting Standards Board.*

*As part of the overall response to the financial crisis, there has of course been a tightening of prudential rules for banks by the Basel Committee on Banking Supervision.*

*The most important element is the package known as 'Basel III'. This package significantly increases minimum levels of capital which regulators will require banks to hold, and also - for the first time - introduces an internationally agreed approach to the quantitative regulation of bank liquidity.*

*The need for clearer presentation of risk information in bank reporting and the need for better and more regular dialogue between auditors and bank supervisors, to enable both parties to perform their duties more effectively and efficiently.*

**Key words:** *IFRS, banking system, bank reporting, comparability of accounts, transparency of reporting*

**JEL classification:** M49, D81

Economic and financial developments in the internationalization of banking in the context of globalization of financial markets have highlighted the importance of harmonizing the financial information provided by banks, especially about assessment and reporting performance and risks of their activity. In addition, due to financial crisis in recent years, there is an increased pressure for the purposes of international homogenization of accounting rules as the basis of published financial information.

As of January 1, 2012, the accounts of credit institutions are kept under treatment under International Financial Reporting Standards adopted under the procedure laid down in Regulation (EC) no. 1.606/2002 on the application of international accounting standards. On December 30, 2010 was published in the Official Gazette, Part I, no. 890, Order of the National Bank of Romania ("NBR") no. 27 for approval of Accounting Regulations in accordance with International Financial Reporting Standards ("IFRS") applicable to credit institutions.

According to NBR Order. 27/2010, the entry into force of new regulations credit institutions will produce a situation that will include differences resulting from implementation of accounting balances in the trial balance prepared for the December 31, 2011 in opening accounts of the financial year 2012 and detailed explanations about the nature of these differences. Also, credit institutions should explain how implementing the amounts in the accounts listed in the chart of accounts applicable from January 1, 2012 and submit changes to accounting policies arising from the transition to IFRS implementation.

All credit institutions, except for those branches in Romania of credit institutions from other countries and branches of foreign credit institutions, Romanian legal entities are required to prepare and publish financial statements in accordance with IFRS in national currency into Romanian . Individual annual financial statements under IFRS audited and submitted to the central bank under the law in force.

A credit institution, the parent government (credit institutions, Romanian legal person that has one or more branches and consolidate the group to which it belongs), to prepare consolidated financial statements and a consolidated report of the directors if they are in one of the following:

a) has direct and / or indirect majority of voting rights in another entity - called subsidiary;

b) may appoint or revoke most members of management and control or the majority of leaders of other entities - subsidiary - and is also a shareholder or associate of that entity;

c) is entitled to exercise a dominant influence over an entity - subsidiary - which is a shareholder or member, pursuant to the clauses included in contracts with that entity or in its Memorandum of provisions of this entity, where subsidiary applicable law allow for such contracts or clauses;

d) a shareholder or member of an entity - subsidiary - and the last two years called as a result of exercising its voting rights, most members of management and control or most managers of subsidiaries;

e) a shareholder or member of an entity - subsidiary - and controls alone, pursuant to an agreement with other shareholders or partners, the majority voting rights in that subsidiary.

Applying IFRS to the accounting change involves significant systems used by banks. Based on data from the accounts, are set profit and dividends distributed to shareholders are determined tax liabilities are calculated on an individual prudential indicators.

Implementation of IFRS as the basis of accounting is completing the implementation of accounting standards in the Romanian banking system, its main advantages:

- disclosure of accounting adapted to the users;
- reduce costs related restatement process for obtaining IFRS financial statements;
- ensuring comparability: financial statements - consolidated financial statements.

Implementation of IFRS involves some additional costs for changes in the internal systems of credit records, preparation of staff involved in financial reporting and for updating the supervisory framework (prudential rules and reporting costs) and the other hand we must shift from an approach based on professional judgment.

The transition to IFRS in the banking system started in 2006 by introducing mandatory IFRS on a consolidated application. In 2009, after an assessment of the banking system as the application of IFRS accounting basis has become mandatory drafting of the second set of IFRS financial statements individually, for information. Most institutions have opted for a direct implementation, no transition period by preparing two sets of RAS and IFRS financial statements.

NBR Order 15/2009 requires the development of two sets of RAS-IFRS financial statements and explanatory statement of differences. IFRS financial statements by restating information obtained from records (RAS) have been issued solely for informational purposes, no impact on distributable dividends or taxes, to ensure comparability.

In 2010-2011 have been issued such regulations to update the accounting and reporting and prudential regulations.

NBR Order 9/2010 provides IFRS as a base of accounting as from 2012, only preparing financial statements under IFRS, the requirement of each institution to develop an action plan and quarterly reporting to the central bank plans out how.

According to NBR Order 27/2010 from 2012, accounting treatment and disclosure requirements of the individual and consolidated financial statements are contained in IFRS. Accounting rules to allow all IFRS accounting treatments.

Later issue accounting regulations, the central bank took steps to update the consolidated reporting framework (NBR Order nr.1/2011) and individuals (NBR Order nr.3/2011)

As was natural, adapting the system of reporting of Romanian credit institutions to international financial reporting system involves a series of losses for these entities. After their frequency, specific banking losses due to changes in the reporting system, are grouped in:

- expected losses currently in the ordinary course of business ;
- unexpected loss frequency of occurrence but low impact.

Expected losses are losses that the bank reasonably expects to incurred during a future period. These losses are a component of business costs and are managed as a cost of business (direct impact on profitability), cost to be covered by the policy establishing fees, interest margins and provisions.

Unexpected losses are losses and probability of occurrence but low frequency impact. Coverage depends on the ability to absorb future losses of a bank's own funds.

As part of the overall response to the financial crisis, there has of course been a tightening of prudential rules for banks by the Basel Committee on Banking Supervision.

The most important element is the package known as 'Basel III'. This package significantly increases minimum levels of capital which regulators will require banks to hold, and also - for the first time - introduces an internationally agreed approach to the quantitative regulation of bank liquidity.

According to IFRS accounting model, conditions for provisioning for impairment are:

- there is objective evidence of impairment as overall result of one or more triggering events, and
- occurrence of an event triggering induces a negative impact on the value and / or time of future cash flows (at an asset or a portfolio of assets)

In applying the model are the following issues:

- identify assets or portfolios of assets to trigger events occurring loss;
- test– for impairment by comparing the recoverable value accounting;
- determination of impairment by comparing the carrying amount and recoverable amount;
- identify triggering events such as significant financial difficulties of the debtor, failure to pay interest or becomes probable that the debtor will enter bankruptcy or other form of financial reorganization.

According to NBR Regulation no.3/2009 specific provisions for credit risk is determined by the date the asset was generated based on simultaneous application of the following criteria:

- financial performance: the provisions are progressively deteriorating performance measure from this perspective one can say that is a model not based on the occurrence of a triggering event, in this case significant financial difficulty;
- debt service;
- initiate proceedings (points classification and loss provisioning category total value of the unsecured loan).

The problem is the depreciation of the domestic banking system continued negative portfolio and adjust asset value (unrealized gains). A study by KPMG in Romania based on financial reporting for the year ended December 31, 2010, updated 30 June 2011 where data were available, made the 22 Romanian banks, shows that the differences between IFRS and Romanian accounting standards expressed as a percentage the total profit and total equity continued upward trend observed in previous periods, mainly because of differences in adjustments for depreciation of portfolio credit losses determined in accordance with each of the two reporting frameworks (such RAS, IFRS).

Thus, the difference related adjustments for impairment losses as a percentage of statutory equity increased from 19% in 2009 to 24% in 2010.

In the first months of 2012, banks have seen an increase in reserves calculated according to the provisions of RSA to over 32 billion, compared with a level of 30.6 billion lei at the end of December 2011. Calculated but after IFRS, applicable to all banks from January 1, 2012, reserves totaled at the end of January almost 22 billion, resulting in a drop of about 10 billion lei, surplus but does not affect the prudential indicators for the central bank was the impact filters.

Prudential filters are dependent on the gap between the size of the accounting provisions and the projected loss in risk management. Prudential mechanisms applied by Member States fall into two categories namely:

- Mechanisms of general or more qualitative nature, do not allow objective verification of the adequacy of provisions: England, Ireland, Czech Republic, Latvia, Lithuania, Estonia
- Mechanisms involving a quantitative methodology provided by competent authority, either replace accounting standards (Spain, Portugal), or apply in addition to accounting standards, by increasing the level of provision of accounting (Malta, Slovakia) or extra accounting adjustment of prudential own funds in their downside (Greece, Slovenia, Bulgaria).

Countries such as Luxembourg, Germany, Hungary, France does not have supervisory mechanisms.

Romanian banking sector proposed filter sets as the reference level, the prudential provisions calculated according to the methodology of Regulation 3/2009, that the difference between prudential provisions (above) and accounting provisions (below) are deducted from own funds (50% Tier 1 funds and 50% of Tier 2)

The main difference between the RAS and the provision of IFRS lies in the acceptance of collateral. If in IFRS reserve is calculated by subtracting the remaining amount refunded guarantee the market value regulations until late last year allowed banks to reduce their exposure by only 25% of collateral value.

**Conclusion** of the study reveals that, in the reform of the accounting system of credit institutions in Romania, after the takeover of Community acquis - while the European standard does not establish rules - NBR promoted European regulatory framework complete with solutions consistent with IFRS principles. As a result, the banking system has significantly improved provisioning rate with the transition to international financial reporting system, freeing up about one third of the provisions made by the Romanian accounting system (RAS), according to data provided by commercial banks. It is important to note that switching to IFRS does not create unhealthy premises an extension of credit, because the central bank rules, in agreement with the banking community were established prudential filters that will not cause an artificial increase of the index solvency of banks.

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