Acta Universitatis Danubius

ŒCONOMICA

The IFRS' Impact on Financial Reporting as well as the Asymmetry of Financial and Accounting Information

Gabriela Mangu (Giurea)[1], Georgiana - Janina Soare[2], Emanuel – Catalin Ciobota[3]

Abstract: The mandatory adoption of IFRS represents an exogenous change in information asymmetry. As IFRS adoption is determined at the individual country level, it is less likely to reflect the endogenous preferences of a single entity. The asymmetry information redundance arises from three potential causes: for some countries, the IFRS increases accounting awareness substantially by providing additional reporting guidelines, such as segment reporting; it considerably increases comparability between countries, which facilitates monitoring and benchmarking between entities and produces a number of contemporary changes related to the implementation of new standards that have helped to reduce information asymmetry in their adoption. The IFRS' conceptual content confirms that there is a convergence between the objectives and guidance of accounting standards, on the one hand, and the objectives and guidance of corporate governance requirements, on the other hand.

Keywords: IFRS; financial reporting; information asimmetry; IASB; fair value; caution; accounting conservatism

JEL Classification: M41

1. Introduction - IFRS and the Asymmetry of Financial and Accounting Information

The asymmetry of information as basis of signal theory corresponds to the idea that the same information is not shared by all. Therefore, the leaders of a company can have information while investors do not have and, even if they had, the same

[1] PhD in progress, ValahiaUniversity Târgoviște, Romania, Address: Str. Aleea Sinaia 13, Targoviste 130004, Romania, Corresponding author:gabriela.giurea05@gmail.com.

[2] PhD in progress, Valahia University Targoviste, Romania, Address: Aleea Sinaia 13 Str., Targoviste 130004, Romania, E-mail: janina_soare@yahoo.com.

[3] PhD in progress, ValahiaUniversity Târgoviște, Romania, Address: Str. Aleea Sinaia 13, Targoviste 130004, Romania, E-mail: ciobota_catalin@yahoo.com.

information would not be perceived in the same way.

It is not unreasonable to believe that information is always fairly shared. The relationships within the entity have become increasingly complex in recent years, and the international openness multiplies the number of interactions between the various agents that constitute its relational base.

The latter aspect can thus be understood as a node of obligations where each relationship (Company/Shareholders - Company/Customers - Company/Employees - Company/Suppliers ...) can be characterised by ***information asymmetry***. The company is defined as a socio-economic entity that unites, in a single geographical area, a specific activity and, in the context of the market economy, a set of people and resources.

The company is a sum of interdependent relationships characterised by information asymmetries. Starting from the question "What are the problems generated by information asymmetry and the means to remedy it?", the study focuses on financial information, information asymmetry and financing decisions. The aim was to show that the occurrence of information asymmetry is a situation where there are entities with missing information or false data compared to other entities in a given market. This information mismatch generates an imperfect form of market whose magnitude and degree of acceptability depends on the nature, characteristics and method of obtaining information, an important contribution to fix the situation and it is accomplished by the application of IFRS.

Beyond presenting the conceptual framework of financial information, there were tackled the impact of IFRSs on financial reporting, asymmetry of information and financial decisions. A first conclusion asserts that the mandatory adoption of IFRS represents an exogenous change in information asymmetry.

Considering that the IFRS adoption is determined at the country level, it is less likely to reflect the endogenous preferences of a single entity. The information asymmetry cut arises from three potential causes, as follows:

• For some countries, IFRS substantially increases the accounting awareness by providing additional reporting guidelines, such as segment reporting;

•IFRS considerably increases comparability between countries, which facilitates monitoring and benchmarking between firms;

• IFRS produces a number of contemporary changes related to the implementation of new standards having contributed to the reduction of information asymmetry in their adoption.

The content of IFRS conceptual framework confirms that there is a convergence between the objectives and guidance of accounting standards as well as the objectives

and guidance of corporate governance requirements. We state that the IFRS are fundamentally different from the accounting system in terms of their philosophy and conceptual framework. Basically, when we talk about IFRS, we are not talking about accounting as a technique, but about information disclosed by accounting as a social practice. There is noted that a higher level of information transparency provided by the IAS/IFRS accounting as a whole should enable users of financial statements to better understand and assess the risks, the gains from possible capital market investments and to make value judgements about the financial position of the entity.

Considering this regulatory framework, the managers who coordinate the financial-accounting department have a certain free option in choosing the methods of accounting transactions. However, they use this discretionary space to model, without violating accounting rules, the presentation and content of financial statements. These choices characterising the entity's accounting policy, are largely subordinated to the objectives of financial communication and of the managers' behavior. Moreover, the information depending on its mandatory or voluntary nature, is not used in the same way in the communication process. The mandatory information must comply with strict rules of presentation and must be verified by auditors, while the second type of information enjoys a greater degree of freedom.

We should rightfully believe that these two categories of information do not comply to the same demands and, from this perspective, we question the level of disclosure and the quality of periodic financial publications in the management of the accounting result.

The conclusion we have reached is that, it is necessary to comply with three essential conditions: confidentiality, availability and integrity in order to avoid informational risks that may lead to the loss of the company credibility in front of investors and all users of information. Analysing the empirical studies in the field, we propose several possible solutions for solving adverse selection problems and cutting information asymmetry: 1. the drafting of optimal contracts between managers and investors, providing for full disclosure of financial information considered confidential by management; 2. "standardisation", i.e. the issuing of regulations requiring managers to disclose full private information on actions taken; 3. the hiring of financial intermediaries (e.g. financial analysts, rating agencies, etc.) to obtain inside information etc.

2. Literature Review

In the current economic environment, many European countries face the complex problem of stimulating growth in fragile economies on the one hand and implementing fiscal discipline on the other. The entities - both large and small - are competing for credit and capital, while banks and other financial institutions are much more cautious

now when making investment decisions. As a result, within this scope, it is increasingly important for entities to be financially transparent and for governments to establish a sound regulatory environment for corporate financial reporting.

The lack of homogeneity regarding the comparability of financial reports for entities coming from different states, imposed the initiation of accounting normalization at regional or international level, being contextually influenced in their choices for the application of specific accounting rules, by their openness in carrying out commercial acttivities or the desire to access foreign capital, therefore the process of international accounting normalization is marked by the works of two major bodies - the EU and the IASB.

The major reform in the regulation of financial reporting, materialized in the adoption of IFRS by over 100 countries worldwide, had an influence on the the reports quality, on the financial decisions by influencing the financing options and the reduction of information asymmetry between the participants in the capital market, thereby facilitating the cross-border capital flows. From a conceptual point of view, IFRS has involved replacing national accounting standards with a single set of rules that entities must follow when preparing their financial reports, and it contributes to a substantial increase in financial accounting information. For example, the entities must provide additional segment information, pension information, etc. (Bae, Tan &Welker, 2008, pp. 593-628).

This information may be valuable to outside investors considering their investment in a particular entity. In addition, by establishing a common set of rules, IFRS was intended to increase the comparability of financial statements and ultimately reduce information asymmetry between capital market participants.

The superior values of IFRS are highlighted by Tweedie (Tweedie, 2006) who states that their application "allows investors to compare the financial results of entities operating in multiple jurisdictions more easily and provides more opportunities for investment and diversification". Leuz şi Wysocki (Leuz & Wysocki 2008) make a number of arguments in favour of IFRS, particularly in terms of reducing information asymmetry, with which Daske et al. (2008), Brochet, Jagolinzer and Riedl (2012), Tan, Wang and Welker (2011), DeFond et al. (2011).

On our opinion, the IFRS mandatory adoption represents an exogenous change in informational asymmetry. As the adoption of IFRS is determined at each country level, it is less likely to reflect the endogenous preferences of a single entity. The reduction of information asymmetry occurs due to three potential causes. Firstly, for some countries, IFRS increases accounting awareness substantially by providing additional reporting guidelines, such as segment reporting. Secondly, IFRS considerably increases comparability between countries, which facilitates monitoring and benchmarking between entities.

For example ,Yip and Young (Yip & Young 2012) show that the IFRS' application facilitates a greater comparison of the transfer of information between entities,, while Ozkan, Singer şi You (Ozkan, Singer & You 2012) demonstrate that IFRS improves executive netting contracts by increasing the number of peer-to-peer entities in the relative performance assessment Finally, IFRS produces a series of contemporary changes related to the implementation of new standards that have helped reduce the information asymmetry around their adoption (Christensen, Hail & Leuz, 2013). Besides reducing information asymmetry, there is no evidence that IFRS systematically affects other determinants of capital structure decisions, such as tax rates and/or financial distortion. As a result, this mitigates potential confounding factors influencing financing decisions and allows us to frame our forecasts based on changes in asymmetric information. Specifically, if IFRS helps the investor to better assess actual assets (e.g., by increasing transparency and the necessary disclosures) or actual investment opportunities (for example, by increasing comparability and allowing investors to better observe growth opportunities on the part of competitors), and Myers and Majluf's models will be reduced and pecuniary order theory predictions will be applied.

Taking into account the authors Albu et al. (Albu et al, 2011) opinion, the IFRS implementation in Romania represents a complex process depending on the characteristics of the accounting system in Romania, as well as on the position of companies in relation to them, without losing sight of all the users of financial statements, their expectations, as well as the features of the accounting profession and its resistance to the new. Therefore, there is required an empirical analysis of the implementation process of the Anglo-Saxon quality standard for the cost-benefit ratio it entailed. In this context, we think that it is fair to wonder ourselves: why would emerging countries prefer to implement this benchmark if they are aware of the obstacles and difficulties involved in this process?

We sustain the opinion of the authors Pascan and Ţurcaş (Pascan & Ţurcaş, 2012), who consider the application of IFRS as a practical approach to increase the comparability and transparency of financial information, the creation of a common language and/or the reduction of informational asymmetry. Nevertheless, there is still doubt and some reluctant behavior on the part of the accounting management in Romania which aims at preparing financial statements in accordance with the IFRS standard requirement and they feel this requirement as a burden, without really noticing the competitive advantage as related to the other entities that obey only the rules of the Romanian accounting system.

At the same time, we would like to emphasize that the motivations for adopting IFRS in Romania are interlinked to the economic development, expressed in more general terms, without mentioning exactly the expected benefits. Although the opinions are divided, there are voices that say that the adoption of IAS/IFRS has led to better

communication in the capital market by disclosing much more relevant and revealing information for investors in the international financial market, ultimately leading to the opportunity to access international capital markets.

The IFRS implementing imposes costs as well. Therefore, a questionnaire sent in the early 2010s to all listed entities, in the process of IFRS assimilation, would reveal that the costs for IFRSs implementation in our country were nevertheless high for such a proposal at that time, a higher coefficient being granted in this regard to personnel training, followed by the information systems adjustment, the use of consultants or finally by the double reporting.

As stated by N. Albu and C.Albu (Albu & Albu, 2012), it has been observed that, the costs for IFRS implementation will be generally higher than the benefits obtained in the short term, if there are taken into account those costs related to contracting services and ongoing training for the maintenance of the three reporting systems (compliance with national regulations, IFRS and taxation).

According to Albu et al. (Albu et al. 2011b), the problem of IFRS implementation in Romania is quite complex, as our country cannot be counted among those countries that successfully apply this model, but as one that shows some resistance to change, among the obstacles encountered are: the importance given to taxation, the lack of rigorous training of the accounting profession as well as human resources.

Although the application of OMFP no.1802/2014 anchors the accounting system in compliance with European directives and IFRS, the managers' information needs are influenced by the nature of activity. From the economic entity's point of view, the managers do not have to wait for the publication of financial statements to have access to accounting information. Comparing with other categories of users, managers have information asymmetry. However, they are concerned about how information is perceived by stakeholders as the financial statements reflect the ability of their management to present the financial position and performance or non-performance of economic entities.

3. Research Methodology

For a relevant study, the herein scientific approach focused on creating the appropriate content that answers to a series of questions, such as:

- Is the research meaningful?
- is the research approach original?
- Are the research tools modern and robust?
- Are the variables considered relevant?

- Can the stated hypotheses be unambiguously tested?

The research methodology was based on adequate methodological and theoretical-scientific support, found in the literature in the form of edited scientific papers, published articles and studies, published statistical data, as well as available research papers or PhD theses. The informational support was completed with operational procedures issued by the Romanian accounting regulatory bodies and international standards applicable in the researched field, and according to these there were added a series of referential web pages.

Along with the theoretical documentation based on the above mentioned information support, there was also taken into account the practical documentation at the level of the entities listed on the stock exchange that published their financial statements, for identification of the real problems they face, to collect and select the data necessary for the analysis, thus ensuring their correctness and veracity. As for completing the research and making a contribution to the state of knowledge, there were used a number of specific research tools, such as: participatory and non-participatory observation, data collection and processing, analysis, synthesis, induction, deductive reasoning, comparison and exemplification.

4. The IFRS' Impact on Concepts and Principles of Financial Reporting

The content of the IFRS conceptual framework confirms that there is a convergence between the objectives and guidelines of the accounting rules as , on the one hand as well as the objectives and guidelines of the enterprise governance requirements, on the other hand.

This aspect is emphasized in corporate governance accounting and through the disclosed financial and non-financial information. Its purpose is to increase the disclosure of financial and non-financial information for a higher users' confidence in financial reporting and to protect shareholders and stakeholders, in particular by identifying the information users and prioritizing it.

Therefore, the purpose of IFRS financial reporting is compatible with the principle of corporate governance that focuses on protecting shareholders and stakeholders. The relationship between corporate governance and accounting should be seen in the sense that accounting information represents the results of the accounting system based on accounting standards that act the same in the "inputs" of the governance system used to assess the effectiveness of management and the organisation of stakeholder relationships, which are summarised in **Figure 1.**

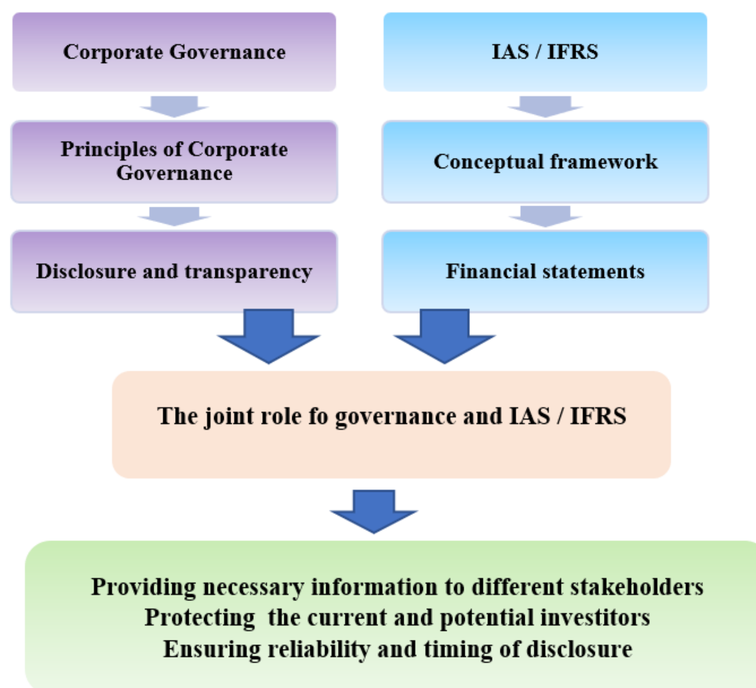

Figure 1. The Relationship between IAS/IFRS Rules and Corporate Governance
Source: https://dspace.univ-ouargla.dz/jspui/.../1/ABPR09F02.pdf

This convergence of standards with the principles of corporate governance has turned the accounting into strengthening the following elements:

• The meaning of the accounting consolidation covered by the standards (IFRS) published by IASB. The compatibility of the accounting standards (IAS) published by IASC has allowed the preparation of fair and regular financial statements for the investors' protection;

• The guidelines for enhancing the effectiveness of accounting disclosures set out in IAS/IFRS, to which each company includes a single standard for disclosures in the context of financial statements, contribute to achieving the fundamental principles of corporate governance, namely disclosure and transparency;

• The image of a reliable and faithful presentation, through the economic matter emphasizing over the legal form provided by IFRS, contributes to fighting the manipulation of the enterprises' results and reducing creative practices, in order to create conditions for the accounting environment necessary to establish the governance principles and to enable the protection of the shareholders' interests.

By its philosophy and conceptual framework, IFRS is fundamentally different from

the accounting system. Basically, when we talk about IFRS, we're not talking about accounting, but about information.

The revolution in the transition to IFRS is not limited to a simple restatement of financial and accounting information recorded in accordance with previous standards.

The alignment of national rules with those of IFRS has also considered their completion by defining key concepts, which are not included in the general IFRS framework as well as the objectives the financial statements must meet and their principles.

As the IASB defines a standardised accounting framework, the IRFS introduce new fundamental concepts such as: knowledge of financial and accounting information, relevance, materiality, reliability in accordance with the real and fair view principle, economic over legal, neutrality and prudence.

The IRFS' central notion derives from the prevalence of the economic over the juridical. The consideration of the company's assets and liabilities at their fair value rather than historical costs relies on the idea that the optimal measurement of a balance sheet item is relative to its mobilisation.

As the entity's value is determined on the basis of all its future cash flows, each item is not considered individually but in the overall context of its corporate purpose. The assets and liabilities are measured at market value; there may be used primarily financial instruments (IAS 39) and if not available or relevant due to non-liquidity, other discounted future cash flow measurement models.

We are talking about an accounting revolution, because the Anglo-Saxon concept of "**fair value"** has a strong financial meaning and opposes two fundamental principles of accounting just as we know them until the advent of IFRS in Europe: on the one hand the historical cost principle that prohibits the initial recognition of balance sheet items at fair value;and on the other hand the prudence principle where the unaccomplished gains are not considered (while being included in IFRS) and the unrealised losses are ensured.

The notion of fair value underlies almost all IFRS accounting principles. It is present in relation to financial instruments, as well as to other topics such as mergers and acquisitions.

This concept establishes the pre-eminence of the balance sheet within the IASB conceptual framework because the result measurement is no longer based on transactions but results from the change in the (correct) value of assets and liabilities. Consequently, it is no longer the profit and loss account that measures the company's performance.

Taking a brief overview of some aspects regarding the fair value, we can take the definitions of fair value prior to the application of IFRS 13 "Fair Value Measurement"

which is classified as the price an asset sale or the price of a liability transfer in a common transaction between market participants at the measurement date. Hence, the associated definition of fair value is shown in ***Table 1.***

Table 1. The Associated Definition of Fair Value Prior to IFRS Implementation

Definition of fair value	Limits
The amount suitable for trading an asset or setting a liability between the parties in a deal where the price is objectively determined.	• There is not mentioned whether the entity buys or sells the asset; •It was unclear what was meant to be settled; • It was unclear whether there was about a market based value or not; • It was not explicitly stated when the exchange or settlement was to take place.

Own source

Analyzing the above mentioned, we can state that in order to rate an asset value the economic entities must operate in a financially active and transparent market, where the fair value is often identified with market value and can be assimilated to one of the situations shown in ***Figure 2.***

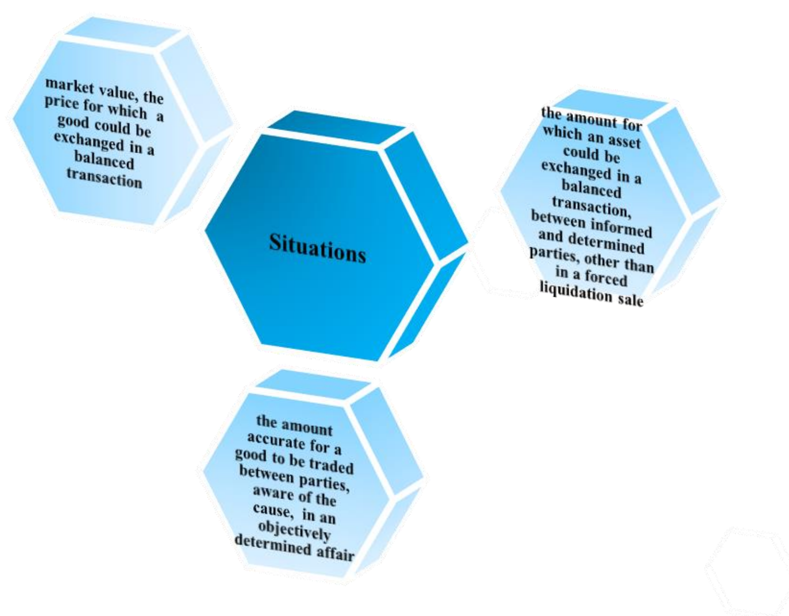

Figure 2. The Situations when the Fair Value is Assimilated to the Market Value
Own source

Therefore, it was concluded that, before the implementation of IFRS 13, the fair value

was a concept particulary used in accounting when preparing financial statements on the valuation date to estimate the price at which a regulated transaction would take place among the participants in a market for asset sale or transfer.

By implementing the IFRS 13, if it is possible to determine the market value of an asset, this value will be stipulated on the balance sheet as it represents the amount at which the asset will be recorded. In this case, the fair value will be identified with the market value. In case it is not possible to determine the market value of an asset, there will be applied specific techniques adjusted by the fair value.

Din această perspectivă, valoarea justă are un înţeles mai larg decât valoarea de piaţă, motiv pentru care considerăm că introducerea noţiunii de valoare justă trebuie privită din această perspectivă, având în vedere aşteptările investitorilor cu privire la capacitatea de a prezice fluxurile viitoare de numerar generate de existenţa informaţiilor, definiţia asociată valorii juste fiind prezentată în ***tabelul nr.2***.

The fair value has a broader meaning than market value, and this makes us to believe that the introduction of its notion should be viewed from this perspective, considering the expectations of investors regarding the ability to predict future cash flows generated by the existence of the information, the definition associated with the fair value being presented in ***table no. 2.***

Table 2. Definition of Fair Value After IFRS Implementation

The fair value is the price of:	Limits
Main market	If the limits don't exist on the main market, then they are findable on the most advantageous market;
The market with the highest volume and level of activity for the asset or liability.	The market that maximzes the value resulted from a possible asset sale or minimizes the value paid for the transfer of liability, after taking into account the transaction and transport costs.

Own source

Hence, it is noted that a higher level of information transparency provided by the IAS/IFRS accounting reference as a whole should enable users of financial statements to better know and assess the risks of exposure, the gains from possible investments in the capital market as well as to make value judgments about the financial position of the enterprise. However, the introduction of IAS/IFRS and fair value in accounting was particularly accompanied by a heated debate on the compromise between the costs and benefits of applying them. The introduction of the ***fair value*** notion into accounting has raised fundamental concerns. According to European Central Bank, it is particularly difficult to determine the fair value of certain assets especially when there is no predetermined market price. In such cases, a fair value must be calculated based on models that may yield very different results for assets with comparable risk

characteristics. The value resulting from this procedure can serve as well as a model to the extent that the data used as input is relevant.

It is known that the international standardizers propose the determination of the fair value for tangible fixed assets (land and buildings) by authorized appraisers, as there are refered to market prices, under the conditions chosen by the company, for investment accounting. These are the reasons as many IAS/IFRS are not recognized by regulatory bodies regarding their usefulness for tax purposes and for capital market regulation.

However, the empirical evidence suggests the manifestation of beneficial effects on its mandatory adoption in Europe by aligning with IFRS and European Directives. In fact, the studies support the idea that the adoption of IAS/IFRS improves the quality of financial reporting, thereby helping to increase the usefulness of financial statements for investors. The manifestation of the IFRS implementation effects has different realisations depending on the institutional framework of entities that show interest in this direction.

The accounting standardisation factors play a key role in determining the quality of the provided accounting information, which for a long term has imposed the need for a single accounting structure at international level, with consequences for the quantity and quality of existing information in both relative and absolute terms. The new principles that were introduced by IFRS had consequences for certain accounting rules. In our opinion, some accounting concepts are doomed to disappear or to be modified for a long term. There is also a systematic application of expense-income reports, based on the principle of separating fiscal years, which requires the recognition of expenses and risks that occur in a year.

Sometimes the content of the accounts has been distorted so that it no longer corresponds to economic reality due to the misuse of the provisions. With IFRS, the conditions for recognizing and measuring provisions are much stricter and we do not choose when to outsource capital gains or losses.

In spite of the attempts to standardise the accounting disclosures, the regional differences (across countries) due to economic, political and ssocial[1] influences will continue to persist and be further developed in the form of empirical research by analysts and academics as a valuable resource that can help regulators and policy makers better understand the possible effects of differences in national accounting standards.

[1] Formularea autorului pe baza ideilor desprinse din lucrare : Contabilitatea şi controlul de gestiune dincolo de frontiere, Analele Universităţii din Craiova, nr.33/2005, p.69-73, autor C.Iacob, 2005.

3. Information Asymmetry and Accounting Conservatism according in terms of IFRS Conditions

The conservatism represents a traditional measure of recording losses immediately and gains after the fact. Some authors consider conservatism as the tendency of accounting professionals to require a greater degree of verification for "recognition of good news "than for" recognition of bad news".

The long-term result of accounting conservatism is materialised in an undervaluation of net assets, noting a relationship between information asymmetry and accounting conservatism. Authors such as Beaver and Ryan (2000), Givoly and Hayn (2000) and others, cited by Lu and Trabelsi (Lu & Trabelsi, 2013) state that financial reporting is characterized by conservatism, with information asymmetry as a determinant and with contracting, litigation, regulation and taxation as causes. However there is a trend in financial reporting standards away from conservative accounting and towards fair value accounting, witness the widespread adoption of IFRS around the world.

According to the IFRS website, there are approximately 120 reporting countries and jurisdictions that allow or require IFRS for listed companies. In the speciality literature, up to date, most of the work has focused on documenting economic change and the consequences of IFRS adoption, such as capita cost, comparability and accounting relevance. However, few papers have investigated the level of information asymmetry after the adoption of IFRS, and there is even less empirical evidence investigating the change in conservatism after the adoption of IFRS. Following the IFRS mandatory adoption by listed companies, which provides a good framework for examining the relationship between accounting conservatism and the information environment, the enterprises are more flexible in their choice of accounting methods than before because IFRS reduces accounting discretion and improves consistency. The stakeholders such as debt holders, shareholders and analysts may change their attitude towards the accounting figures presented in the financial statements and nevertheless change the conservatism requirement as well.

The conservatism plays an important role in our topics as, even if the mandatory adoption of IFRS has had an influence on conservatism, the level of entities' accounting conservatism that opted early and voluntarily for a switch to IFRS has remained unchanged. ***The aim of IFRS has been to: improve international financial reporting, increase comparability, reduce information asymmetry and the capital cost.***

When they reach a certain level, the standards normalizers try to reduce information asymmetry between entities and external investors by incorporating more unconditional value into financial reports. Nevertheless, because the conservatism represents a simple response to changing asymmetric information (LaFond & Watts,

2008), attempting to reduce the information asymmetry by decreasing conservatism may not be effective.

Regarding the accounting conservatism, most authors make use of current asymmetry by recognising gains and losses and consider the following assumptions:

Ip.1.- The accounting conservatism changes after the adoption of mandatory IFRS;

Ip.2.-The change in accounting conservatism after IFRS adoption is positive and interlinks to the change in information asymmetry;

Ip.3. – The Conservatism is positive and information environment of entities under adopted IFRS.

The researches carried out in these directions have lead the following conclusions:

- the accounting conservatism decreases if investors demand a better quality of IFRS-based financial reports based on transparency and information asymmetry decrease, but it will increase if investors expect accounting data to be less verifiable;

- to maintain financial reporting as an information source, the companies tend to increase the accounting conservatism thus enhancing the trustworthiness of financial reports;

- the accounting conservatism increase represents an effective mechanism for a stodgy credibility of disclosures, even if investors expect better quality of IFRS reporting.

- the information asymmetry is positively related to accounting conservatism, and the switch to IFRS weakens the relationship between them due to the fact that the application of IFRS lowers the level of accounting conservatism and therefore diminishes the credibility of accounting, thus threatening the role of accounting as a source of information. Consequently, it is better to maintain accounting conservatism up to a certain level rather than blindly lowering it.

- the higher levels of accounting conservatism can generate a more informed capital market;

- the conservative accounting increases the information environment by providing credible information, as there is a significant positive relationship between conservatism and analysts.

6. The Prudence and the Asymmetric Process in the Valuation of Assets and Income/Liabilities and Expenses

he application of the ***principle of prudence*** in financial accounting has recently become a highly controversial subject involving conflicting views on the

appropriateness of imposing neutrality as a desirable characteristic of the information disseminated by financial statements.

Until 2010, the discussion of prudence in international accounting standards was conducted in the broader context regarding the qualitative characteristics of financial statements. However, the IASB dropped 2010 the nomination of prudence in the conceptual framework of financial reporting as a qualitative characteristic of financial information, although many studies in the literature and academic circles considered necessary a conservative approach to financial statements. Moreover, Richard Barker (Barker, 2015), considers that accounting is implicitly conservative, and the need of neutrality in financial reporting also leads to accounting conservatism. He argues that, accounting conservatism is not generally intentional, but is caused by conceptual and practical reasons.

By sustaining the users' information needs, IASB has released a discussion draft aiming at revising the conceptual framework for financial report, and one of the objectives consists of reenforcing the concept of prudence. This time, as part of the scientific approach to the monetary units valuation, the IASB proposes a prudence analysis only as a concern for neutrality "when making judgements under uncertainty".

According to Gerald Feltham and James Ohlson (1995), who have tackled the accounting conservatism in terms of the net assets understatement, the IASB defines the prudence as conservatism reflected in the balance sheet.

The accounting conservatism approach is specific to Civil Code-based (continental) countries where debt financing plays an important role. On this regard, we assume that the IASB prefers this way of defining conservatism because International Financial Reporting Standards have been adopted by the European Union and many European countries have a tradition of debt financing.

Regardless its motivations in the topic draft, the IASB explains, in the chapter about Fair Representation, paragraph 2.18 the followings: "Exercising prudence means that assets and income are not overstated as well as the liabilities and expenses are not understated. The prudence also does not allow the assets and income understatement or liabilities and expenses overstatement, because such misstatements may lead to the income overstatement or the expenses understatement in future".

Specific accounting theory and practices "entangle aggressiveness and conservatism in earnings valuation. The more aggressive the accounting methods, the lower the quality of earnings; the lower the quality of earnings, the higher the assessed risk; the higher the assessed risk, the lower the company value." The author also proposes a classification scheme of earnings manipulation methods, taking into account the principle of prudence in expressing the financial result (Table 3):

Table 3. Methods of Handling Gains According to Van Greuning's Conception

Elements of financial statements	Aggressive treatment (in accordance with IRFS' intentions)	Conservative Treatment
Revenue resulted from current activities	Aggressive commitments	Installment sales or cost recovery
Stocks	FIFO-IFRS treatment	LIFO (where allowed - not allowed by IFRS)
Depreciation	Straight-line (usually in accordance with IFRS) with higher residual value	Accelerated depreciation methods
Uncertain guarantees or claims	High-value estimates	Low-value estimates
Depreciation period	Higher or lower	Lesser or decreasing

Source: adapted from Van Greuning, H., International Financial Reporting Standards, IRECSON Institute, 2007

According to the IASB General Framework "the prudence means including a degree of caution in the exercise of judgments necessary to make the required estimates under conditions of uncertainty, so that assets and revenues are not overvalued, and liabilities and expenses are not undervalued".

This does not mean that the prudence application allows the establishment of hidden reserves and/or excessive provisions, for fear they might affect the neutrality of the financial statements and thus their credibility. Regarding the content of the above mentioned statements, we can prove that they were supposed to serve the IASC, which later became the IASB, in the process of developing or revising standards and interpretations. Hence, if we look back, the standards issued by the normalization bodies have offered a multitude of options in assessing the elements of the financial statements and especially of the assets one. One option was mostly prudential and the second one rather unoredictable. In time, the number of options has decreased considerably, this being an objective of the international body, manifested especially in the process of convergence with the products issued by the American body FASB (Financial Accounting Standard Board).

Summing up this analysis, we note that an exaggerated or attenuated caution will have the effect of sacrificing neutrality. Nevertheless the prudence, even justified, presupposes an asymmetrical treatment in the valuation of assets and revenues as well as of debts and expenses. Prudence means taking into account the certain losses as well as the possible ones, and in terms of gains the certain losses are emphasized instead of the potential ones. Is this asymmetric treatment that of affecting neutrality from the outset, by taking into account the estimates under conditions of uncertainty?

Regarding the establishment of accounting provisions we sustain the opinion of the author Hendriksen (Hendriksen, 1982) according to which the principle of prudence

is "... a very mediocre method to deal with the existence of uncertainty in the assessment of assets, liabilities and results". The worst is that it includes a complete distortion of the accounting figures.

It is particularly dangerous because of its capricious effects. Therefore, the accounting figures established with prudence do not allow a correct interpretation." Currently, we are witnessing a reformulation of the accounting model on the value which consists in reconsidering the fundamental principles of the evaluation. The accounting is evolving from the historical cost system to the present value system.

Analysing the virtues of prudence in building profit and maintaining capital, there must be mentioned the advantages of using fair value in financial information, respectively:

- fair value valuation provides objective information that takes into account market trends and valuation methods for forecasting cash flows;

- a better reflection of the economic reality as the fair value may be a market value (market value) or a discounted value (use value);

- diminishing the possibilities that managers have to adjust the desired profit as the evaluation is based on exogenous values (as it was shown before: the market value or the updated value).

From our point of view, the fair value ***(full fair value)*** promotion by the IASB and FASB standardization bodies can significantly contribute to the improvement of the accounting information released by the financial statements, thus increasing their usefulness for its users, but it can also be extremely subjective, by encouraging the distortions in the financial statements as well the control of those who estimate it. This can be related to the fact that fair value measurement involves the inclusion of virtual" items like potential gains or losses and they are generated by market developments. The literature occasionally mentions some alternatives, regarding the trends in valuation methods, but the arguments are not sufficiently convincing.

The historical cost would provide a significantly lower degree of comparability and relevance of the information, being obviously rejected by the users of this information, especially by the financial investors. In this direction, there is **expected** the use of two assessment frameworks, such like:

• historical cost - which is a fair value at initial value(input);

• fair value - which is a subsequent measurement instrument relative to the original one (for financial reporting purposes).

However, the deliberately concern on conservative estimates of assets, liabilities, income or equity may sometimes be considered desirable to counteract the effects of management estimates that have been perceived as overly optimistic. In this way,

understatement of assets or overstatement of liabilities in one period often leads to overstatement of financial performance in subsequent periods - an outcome that cannot be described as prudent or neutral.

7. Conclusions

The ***asymmetrical information*** theory says that individuals who cooperate in different situations have varying degrees of knowledge on the same subject. The individual needs information or knowledge in order to choose the accurate resources. Certainly information aquisition is an economic activity for goals achievement.

The individual finds himself in the position of using other resources to get more information since any information is expensive. In this circumstances, the individuals will not choose to be self-knowledgeable or wise, but they will always prefer to reach an optimal level of ignorance, as those resources must be allocated to other areas, too.

The major reform in financial reporting regulation, materialised in the IFRS adoption by more than 100 countries around the world, has influenced the quality of reporting and financial decision making by controlling the financing choices and diminishing information asymmetry between capital market participants as well as facilitating cross-border capital flows.

In philosophy and conceptual framework, IFRS are fundamentally different from the accounting system. Basically, talking about IFRS, we refer to accounting more as a social practice rather than as a technique. There is notable that a higher level of information provided by the IAS/IFRS accounting framework allows the financial statements' users to better understand and assess the risks of their exposure, the gains from possible investments in the capital market as well as the financial position of the entity.

References

Albu, C.; Albu, N.; Bunea, Ş.; Calu, D. & Gîrbină, M. (2011). A story about IAS/IFRS implementation in Romania – an institutional and structuration theory perspective. *Journal of Accounting in Emerging Economies*, vol.1, nr. 1.

Albu, N. & Albu, C.N. (2012), International Financial Reporting Standards in an emerging economy: Lessons from Romania. *Australian Accounting Review*, vol. 22, nr. 63.

Bae, Kee-Hong; Hongping, Tan & Welker, Michael (2008). International GAAP differences: the impact on foreign analysts. *The Accounting Review*, 83.

Barker R. (2015). Conservatism, prudence and the IASB's conceptual framework. *Accounting and Business Research*, vol. 45, no. 4;

Christensen, Hans B.; Luzi Hail & Leuz, Christian (2013). Mandatory IFRS reporting and changes in enforcement. *Working Paper*, University of Chicago.

Hendrixen, E.N. (1982). *Accounting Theory.* Editura Richard D, Irwin, Inc.

Iacob C. (2005). Accounting and management control beyond borders. *Annales of the University of Craiova*, nr.33/2005.

LaFond, R. & Watts, R.L. (2008). The Information Role of Conservatism. *The Accounting Review*, vol. 83, no. 2, pp. 447- 478. http://aaapubs.org/doi/abs/10.2308/accr.2008.83.2.447?journalCode=accr.

Leuz, Christian & Wysocki, Peter D. (2008). Economic consequences of financial reporting and disclosure regulation: a review and suggestions for future research. *Working Paper Journal of Accounting Research*, vol 5, Issue 2.

Leuz, Christian & Wysocki, Peter D. (2016). The Economics of Disclosure and Financial Reporting Regulation: Evidence and Suggestions for Future Research. *Journal of Accounting Research*, vol 54, Issue 2, https://doi.org/10.1111/1475-679X.12115.

Lu, C. & Trabelsi, S. (2013). Information Asymmetrx and Accounting Conservatism under IFRS Adoption. *CAAA Annual Conference*. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2201206.

Ozkan, Neslihan; Zvi, Singer & Haifeng, Youd (2012), Mandatory IFRS adoption and the contractual usefulness of accounting information in executive compensation. *Journal of Accounting Research* 50, pp. 1077–1107, https://doi.org/10.1111/j.1475-679X.2012.00453.x.

Păşcan, I.D. & Ţurcaş, M., (2012). Measuring the impact of first-time adoption of International Financial Reporting Standards on the performance of Romanian listed entities. *Procedia Economics and Finance 3*.

Tweedie, D. (2009). Prepared statement of Sir David Tweedie. *Chairman of the International Accounting Standards Board before the Economic and Monetary Affairs Committee of the European Parliament*. Brussels. https://www.iasplus.com/en/binary/europe/0909 tweedieeconcommittee.pdf.

Van Greuning, H. (2007). *International Financial Reporting Standards*. Publishing House: IRECSON Institute.

Yip, Rita W. Y. & Young, Danqing (2012). Does mandatory IFRS adoption improve information comparability? *The Accounting Review* 87, pp. 1767–1789. http://aaapubs.org/doi/10.2308/accr-50192?code=aaan-site.