

IFRS ADOPTION AND ANALYSTS FORECASTS ACCURACY IN ROMANIA: A CASE STUDY

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Abstract: *This paper seeks to explore the impact of International Financial Reporting Standards (IFRS) adoption in Romania on analysts' forecasts accuracy by means of a case study on one of the best performers on the Romanian market: OMV Petrom SA. The IFRSs are considered high quality accounting standards that are expected to increase transparency and decrease forecasts errors. Accordingly, this paper analyzes the characteristics of forecasts accuracy of earnings computed both under IFRS and local General Accepted Accounting Principles (GAAP). The results show that IFRS based forecasts tend to be more accurate, confirming the international trends.*

Key words: analysts' forecast accuracy, IFRS adoption in Romania, case study, OMV Petrom SA

JEL classification: G32, M41

Introduction

The IFRS adoption is aimed at increasing comparability and transparency and, thus, at helping users of financial statements in anticipating companies' future performances. As analysts are often considered representative for the market, an important stream of research has concentrated on investigating the impact of IFRS adoption on analysts' forecasts accuracy. And there is an increasing amount of evidence showing that IFRS implementation has indeed led to a decrease in forecasts errors.

However there is little research documenting this economic benefit of IFRS adoption for emerging countries. Accordingly, the purpose of this paper is to explore the role played by IFRS financial information in increasing forecasts accuracy for Romanian listed companies. In order to do this, we have performed a

case study on OMV Petrom SA, which is one of the best performers on the Bucharest Stock Exchange.

Literature review

Financial information is an important ingredient for analysts' forecasts and quality financial reporting, such as the one prepared under IFRS, is therefore a key driver of forecasts accuracy.

Increased disclosure has been proved to increase forecasts accuracy (e.g. Vanstraelen, Zarzeski and Robb, 2003; Hope, 2003), as more information available to financial analysts enables them to better anticipate entities' future performance. And the same economic benefit was also documented for IFRS based financial information, as the international accounting standards have extensive disclosure requirements.

Thus, Hodgdon *et al.* (2008) explored the impact of firm compliance with the disclosure requirements of IFRS on forecasts accuracy, and documented a positive relationship. Based on these findings Hodgdon *et al.* (2008) emphasize the role of full IFRS compliance and suggest that disclosure requirements of IFRS, when fully applied, „enhance (...) the ability of financial analysts to provide more accurate forecasts”.

As the European Union mandatorily introduced IFRS financial reporting for consolidated accounts of listed companies beginning in 2005, there is an important body of literature investigating the economic benefits of the IFRS adoption for European countries.

For instance, based on a sample that included 14 European Union countries which compulsory adopted IFRS starting in January 1, 2005 (Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Portugal, Spain, Sweden and the United Kingdom), but also Switzerland, Norway and Australia, Brown *et al.* (2009) showed that analysts' forecasts accuracy increased after IFRS mandatory implementation. For the German capital market, Ernstberger (2008) has documented empirically that analysts' forecast accuracy improved after IFRS adoption. And Tan *et al.* (2009) provided similar results based on an international sample, including most of the European countries. Tan *et al.* (2009) included three ex-communist countries (Check Republic, Hungary, and Poland), that could be compared to Romania in terms of their capital market' size.

Byard *et al.* (2010) also investigated the effect of the mandatory IFRS implementation in European Union, showing that analysts forecast errors and dispersion decrease significantly in countries where enforcement is strong and local GAAP is significantly different from IFRS. In the cases where enforcement is weak, but local accounting standards differ significantly from IFRS, analysts forecasts errors and dispersion decrease more for companies inclined towards transparency in financial reporting.

Horton *et al.* (2012) have also documented the economic benefit of reduced forecasts errors for mandatory IFRS adoption. They also found increased accuracy for companies voluntarily applying IFRS, but to a lower extent. Horton *et al.* (2012) further explored two underlying IFRS drivers of forecasts accuracy, that is the quality of financial information in compliance with IFRS and the comparability induced by IFRS standards, showing that they both contribute to decreasing forecasts errors.

Beuselinck (2012) also investigated the effect of mandatory IFRS adoption in European Union on the information processing of financial analysts, showing that, after the switch to IFRS, there was a significant increase in both public and private information which triggers no change in the forecasts dispersion among analysts.

There are also studies investigating the effect of IFRS adoption on analysts' forecasts accuracy in other non-European countries, such as those from the Asia-Pacific region. Cheong *et al.* (2010) analyzed pre- and post-adoption samples of companies from Australia, Hong Kong and New Zealand in order to determine the impact on forecasts accuracy of a different accounting policy applied for intangibles as a result of IFRS implementation. The new accounting treatment was found to decrease forecasts errors across the companies included in the sample. Cotter *et al.* (2012) analyzed a sample of 145 big listed Australian companies showing that analysts' forecast accuracy increased after IFRS adoption.

Although most research results documented the superiority of IFRS in supporting analyst' predictive activities compared to domestic accounting standards, there is, however, inconclusive evidence that IFRS is better in this direction than US GAAP. Based on a sample of 58,832 firm-year observations from 33 countries, Atwood *et al.* (2011) investigated earnings persistence and the association between current earnings and future cash flows, showing that positive earnings reported under US GAAP are just as persistent as those reported under

IFRS, and that, furthermore, they are more closely related to future cash flows than the ones under IFRS.

There is however no research focusing on the IFRS impact on analysts' forecasts in emerging economies. This is probably due to the lack of available information and the difficult setting of such markets where the interplay of various institutional factors is difficult to comprehend and isolate. For the emergent market of Romania, Ionascu and Ionascu (2012) have showed that the vast majority of Romanian analysts expect the IFRS adoption to improve their forecasts accuracy to a great extent. Among the main features of IFRS that can trigger such an effect, financial analysts have named the increased comparability of IFRS financial statements, the use of fair values and the extensive disclosure requirements within the IFRSs.

In this context, this paper tries to investigate the effect of IFRS adoption on analysts' forecast accuracy, by means of a case study on a listed Romanian company.

Methodology

The case study focuses on OMV Petrom SA, which is one of the best performers on Bucharest Stock Exchange (see Fig. 1 below). For forecasts of earning per share (EPS) computed under local GAAP, we used monthly predictions available for Petrom in Thomson Reuters' I/B/E/S data base. As for forecasted and actual values of EPS computed under IFRS we used Petrom's (2011) annual reports and IEBA Trust (2011a, 2011b) estimates.

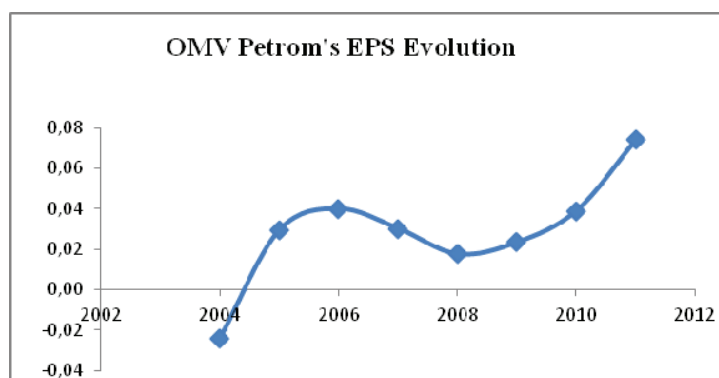


Fig. 1. Evolution of OMV Petrom's Earnings per Share (Local GAAP)

The following regression model (firm, month and year subscripts omitted for convenience) are used to investigate the properties of analysts' forecasts:

$$ERROR = \alpha_0 + \alpha_1 IFRS + \alpha_2 HORIZON + \varepsilon$$

Where:

ERROR The absolute difference between actual EPS computed under local GAAP or IFRS and the monthly median consensus forecast

IFRS A dummy variable that takes the value of 1 if EPS is computed based on IFRS, and 0 otherwise.

HORIZON I/B/E/S forecast period indicator, integer number indicating the financial year for which the forecast is made (1 for the year before the publication of the annual report, 2 for the year before 1 etc).

Research results

The values obtained after the operationalization of the variables are presented in table 1 below:

Table 1: Descriptive statistics

Variables	ERROR	IFRS	HORIZON
Mean	0,022	0,088	2,221
Standard deviation	0,045	0,094	1,129
Minimum	0	0	1
Maximum	0,33	1	5
Observations	226	226	226

Regression results are summarized in Table 2 below:

Table 2 Regression results

Variables	Coefficients	t	Sig.
(Constant)	-,002	-,585	,559
IFRS (-)	-,146	-7,242	,000
HORIZON (+)	,001	,932	,353
Lag1 (-)	1,019	23,923	,000
Observations	225		
Adjusted R square	,761		
F statistic	238,779 (sig. ,000)		

The results showed a negative correlation between the variable IFRS and forecasts errors, that is, analysts' forecasts which are computed based on IFRS financial statements tend to be more accurate. Although HORIZON was expected to have a positive impact on forecasts errors, as predictions tend to be more accurate near the date of the publication of financial statements, it does not have a significant impact. In order to avoid errors' autocorrelation a first order lag of the dependent variable was introduced in the regression equation.

Conclusions, limits and further research

The paper investigates the impact of IFRS adoption in Romania on analysts' forecasts accuracy by means of a case study on a listed Romanian company. The results show that EPS forecasts computed under IFRS were more accurate for OMV Petrom SA than those computed based on local GAAP, which confirms the international trends. However, these results have to be taken with reserves, as they represent just a single case analysis and cannot be generalized to the whole Romanian capital market.

Accordingly, research is needed to further investigate the impact of IFRS adoption on forecast errors in order to fully comprehend the role played by IFRS financial reporting in supporting investment decisions in emergent economies.

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