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Impact of the IFRS on the disclosure of income tax figures by Romanian listed companies

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Abstract: The transition to IFRS in Romania, in the separate financial statements (in 2012) led to the application of new rules in the accounting for income tax. We found significant differences between accounting and taxable income, which can suggest a trend towards more de facto disconnection between accounting and taxation. Deferred tax liabilities are more present than deferred tax assets in the listed companies' balance sheet, even if the weight of these liabilities is less important that the weight of the deferred tax assets. The effective tax rate (calculated in three ways: with total tax, current tax and cash paid tax) is, in most cases, higher that the Romanian statutory rate. As expected and consistent with several previous studies, fixed assets are the main source of temporary differences and, thus, of deferred tax assets and liabilities. The main contribution of the paper consists in filling a gap in the literature on the impact of the IFRS in Romania, in the special topics concerning income taxes (current and deferred), in the measure of the difference between net accounting income and taxable income, as well as in calculating and interpreting the effective tax rate for the Romanian listed companies.

Keywords: transition to IFRS, deferred taxation, effective tax rate, Romanian listed companies

JEL codes: M41

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1. Introduction

The relations between accounting and taxation have often been approached from the point of view of the gap between net income and taxable income. Many studies analyze the differences between income measurement accounting criteria and fiscal criteria and they notice the existence of a more or less important disconnection between accounting and taxation. These differences are an important point to take into account when classifying accounting systems (Gee *et al.*, 2010; Nobes, 2011; Kvaal & Nobes, 2013; Hellman *et al.*, 2015) and they allow one to construct an alternative measure of income (Graham *et al.*, 2012) or of companies' aggressiveness in managing accounting income and/or to evade taxes. Accounting standards themselves can take into account this gap between net income and taxable income. In the case of companies listed on a financial market, the users' needs for information are such that regulators have been determined to set complex and detailed rules for the recognition and the presentation of income taxes, as well as for current income tax or deferred income taxes.

In the accounting recognition of income tax, the simplest solution would be to limit oneself to take into account only current tax for the fiscal year); this would lead to a expense and a liability whose values would be taken as such in tax returns filled in by each individual entity. This is the only solution featured in the accounting for individual companies in many European countries. On the contrary, in the case of more sophisticated accounting regulations – such as IFRS, as well as US GAAP and other standards applicable to listed companies – the recognition of the current tax is not enough; the latter is complemented by deferred taxes. In order to justify the obligation to account deferred taxes, IAS 12 reminds that "if it is probable that recovery or settlement [of an asset, respectively, of a liability] will make the future tax payments larger (smaller) they would be if such recovery or settlement were to have no tax consequences, the […] standard requires an entity to recognize deferred tax liabilities (assets), with certain limited exceptions". Another justification proposed by IAS 12 for the recognition of all (current and deferred) taxes on income consists in a characteristic feature of accrual accounting – the tax consequences of transactions and other events must be recognized in the same way as the transactions and the events themselves. These arguments used by IAS 12 are strongly supported by general accounting principles and by the guidelines imposed in IASB's *Conceptual Framework of Financial Reporting*. This does not prevent initial accounting recognition and the settlement of deferred taxes from making book-keeping more costly and more complex. At the same time, users encounter more difficulties in comprehending certain essential financial information, such as net income or comprehensive income.

The 34th European directive (European Parliament, 2013) does not mention deferred tax, except in the case of information to be disclosed in notes by medium and large-size companies and by public interest entities – “when a provision for deferred tax is recognised in the balance sheet, the deferred tax balances at the end of the fiscal year, and the movement in those balances during the financial year” must be disclosed. Therefore, this applies only to one category of companies and to only one provision, which is a liability disclosed in a particular manner.

Since 1994, Romanian Accounting Standards (RAS) have been following European directives more or less faithfully. Except for the period 2001-2005 - and only for certain large companies which had to apply standards harmonized with IAS and with European directives – the RAS do not mention deferred tax and therefore, the obligations of Romanian companies were limited to the recognition of current taxes.

In the early 2000s, as a result of pressures from international financial bodies (the World Bank and the IMF), the Romanian standard-setter tried to introduce the International Accounting Standards (IAS) for certain companies. This orientation towards IAS (which have become IFRS) was all the more powerful since Romania wanted to become a member of the EU and so, it had to adjust to the new requirements for the European financial reporting rules (Regulation 1606/2002). Thus, beginning with 2007, IFRS were going to be applied only in the consolidated financial statements of listed entities and in certain other companies (in the latter case, generally, they were to be applied on a voluntary basis). Given that the Regulation 1606/2002 allows member states to extend the obligation of the enforcement of IFRS, beginning with 2012, the Romanian authorities imposed the use of IFRS in the individual accounting of companies listed on a regulated market and in the individual accounting of other entities (especially banks, irrespective of whether they are listed or not). This is how IFRS were introduced in the current accounting practice of several dozens of Romanian firms. This is also how Romanian accountants (re)discovered deferred taxes.

On the other hand, Romanian accounting after 1990 (the beginning of the modern market economy in Romania) was built on bases which connected it strongly with taxation. Istrate (2009: 25-26), Istrate (2011), Fekete *et al.*. (2012), Păunescu (2015) notice that since the 1990s, the connection between accounting and taxation (especially in the case of income tax) has been very tight, both *de jure* and *de facto,* and that the *de jure* disconnection which started in the 2000s (especially beginning with 2004) has not always been consistently followed *de facto*. Even the application of IFRS does not always ensure the disconnection between accounting and taxation at the level allowed by current Romanian accounting and fiscal regulations. This *de facto* connection is the result of choices made by companies in

the sense of simplifying their accounting; often, a fiscally accepted accounting option is preserved so as to limit tax adjustments when calculating income tax. Despite these states of fact, which are very frequent in the accounting practices of Romanian firms, the application of IFRS and their implementation by foreign shareholders of certain large Romanian companies, have contributed to the fact that, gradually, the *de facto* disconnection between accounting and taxation would become more and more visible. In the case of listed companies, this disconnection leads to accounting values which often differ from the fiscal values of certain assets and liabilities and thus, to the emergence of deferred taxes.

To our knowledge, the impact of the IFRS on accounting figures of Romanian listed companies, concerning income taxes, has not been studied so far.

The study, which is essentially descriptive, aims to identify the impact of IFRS on the disclosure of information on income tax in the financial statements of Romanian companies listed on the Bucharest Stock Exchange (BSE). Apart from the emergence of deferred taxes (liabilities and assets in the balance sheet, expenses/revenues in the income statement), we have measured the differences between net income and taxable income, reconstituted starting from the tax expense and the statutory tax rate: these differences are very important – they often go beyond 50% and, on average, IFRS have led to their augmentation. In the balance sheets, the deferred tax assets appear less frequently than deferred tax liabilities, but liabilities are much more significant in terms of weight in total assets. In the income statement, deferred taxes are recognized in almost two thirds of the listed companies – a negative deferred tax expense is recognized much more frequently than a pozitive one. In the notes, only two thirds of the listed companies give a clear image of how the effective tax rate comes close to the statutory tax rate and the items proposed to describe these differences are quite general. We have also calculated the effective tax rate which does not change radically with the application of IFRS.

Our paper fills a gap in the literature on the impact of the IFRS on the income taxes of Romanian listed companies. The main contributions of the papers are:

- we found an empirical confirmation of the increasing disconnection between accounting and taxation for the listed companies applying IFRS – the differences between net income and reconstituted taxable income are significant;
- the effective tax rate (ETR) calculated for Romanian listed companies emphasis a very particular situation: ETR is systematically and significantly higher than the statutory rate, in contrast to the situation in many other European or non-European countries;

- our result could be compared with the situation in other countries as to obtain an image of the relationship between accounting and taxation at the EU level or, more realistically, at the level of Central and Eastern European countries.

The following sections of this article provide a literature review, the description of our methodology and of the used sample, the main results and our conclusions.

2. Literature review

The analysis of the relation between accounting and taxation refers mainly to the income tax: the accounting and fiscal rules to measure income, the differences between net income and taxable income, and starting from that, the study of the more or less important connection between accounting and taxation. One can add here the impact of differences between accounting and taxation on the quality of earnings reported by listed companies, the impact of deferred taxes on accounting figures, the relation between taxes and the financial market prices, the influence of obligations for the financial recognition of the relation with fiscal audits, the relation between these differences and the financial auditor's opinion … The differences between accounting and taxation are due to at least two factors (Hanlon & Heitzman, 2010): the different objectives of accounting and taxation and the "aggressiveness" in managing the income or of the taxable income, so as to reach certain objectives.

In this study, we shall start with a review of the literature on the relation between accounting and taxation in Romania, followed by the main results reported in the literature on the IFRS impact on income tax, the obligations established by IAS 12 to disclose taxes and the role of deferred taxes.

2.1 The relationship between taxation and accounting in Romania

The 1990s witnessed the emergence of the market economy in Romania. Istrate (2011) retraces the evolution of the relation between accounting and taxation between the 1990s and 2011 and notices that, in the beginning, there was a strong connection between them and in time, fiscal authorities became aware of the fact that the objectives of taxation do not necessarily converge with those of accounting. After a first stage of almost total alignment between accounting and taxation - Filip and Raffournier (2010) notice that net income and taxable income are strongly connected - successive reforms, both in accounting (under the influence of the IFRS) and in public finance, have led to the current situation which is characterized by a *de jure* disconnection between accounting and taxation but

which, in practice, is accompanied by numerous situations of *de facto* connection (Fekete *et al.*, 2012; Păunescu, 2015; Deaconu & Cuzdriorean, 2016). The first stage in the application of IAS in Romania (2000 - 2005) was characterized by partial conformity with IAS - the connections between accounting and taxation remained strong (Filip & Raffournier, 2010; Ionașcu *et al.*, 2014). By interviewing persons directly involved in the enforcement of IFRS in Romania, Albu and Albu (2012) found that the transition to IFRS was going to lead to extra costs, including for reasons that had to do with obligations to supply fiscal information that begins to differ from accounting information.

2.2 Impact of the IFRS on some accounting numbers: tax expense, tax assets and/or liabilities

In Europe, the compulsory application of IFRS starting with 2005, has determined IAS 12 *Income Tax* to be applied by a large number of companies (in certain countries, similar standards were in force before this date, for certain entities). In fact, even though the initial obligation to enforce IFRS referred only to the consolidated financial statements of listed groups, certain member states chose to extend their application to other situations: the individual accounting of listed companies, consolidated and/or individual statements of non-listed companies (Table 1).

In general, the introduction of IFRS has generated important changes in the accounting – taxation relation: Chen and Gavious (2015) review several studies which document an augmentation of disparities between accounting and taxation in certain countries which adopt IFRS; this allows decision-makers to put in place complicated fiscal mechanisms, with minimal effects on net income. Guggiola (2010) notices that a tight relation between accounting and taxation is often a limit to the full adoption of IFRS.

Table 1. Use of options provided by IAS Regulation (1606/2002), in July 2014

Application of IFRS in the individual accounting of listed companies	Application of IFRS in the consolidated accounting of non-listed companies	Application of IFRS in the individual accounting of non-listed companies
14 countries impose it	16 countries impose it	12 countries impose it
8 countries permit it	12 countries permit it	10 countries permit it
6 countries do not permit it	no country forbidden it	6 countries do not permit it

(*Source:* http://ec.europa.eu/finance/accounting/docs/legal_framework/20140718-ias-use-of-options_en.pdf)

Kvaal and Nobes (2013) study how companies from five different countries in terms of their position in the classification of accounting systems enforce the information disclosure rules imposed by IAS 12. The goal of Kvaal and Nobes' study (2013) is to see if the enforcement of IFRS leads, in different countries, to similar disclosures concerning income taxes, and if listed companies disclose sufficient information for the analysis. Kvaal and Nobes' conclusion (2013) is that, for the five countries which they study (Australia, France, Germany, Spain and Great Britain), despite the generalized application of IFRS, there remain systematic differences in how they report income tax information.

The adoption of IFRS has led to the increase of the total fiscal expense of companies in all EU member countries (between +3.3% and +10.1%) by enlarging the taxable basis (Haverals, 2007). Gee *et al.* (2010) find that, for a country where the relation between accounting and taxation was very tight – Germany – the enforcement of IFRS is materialized in the significant reduction of fiscal influence on IFRS accounting practices, especially for large groups.

Chen and Gavious (2015) notice a significant decrease of conformity between accounting and taxation with the enforcement of IFRS, but they find that the flexibility thus introduced for the manipulation of net and taxable incomes can be counter-balanced by a better management of taxes by fiscal authorities.

For the case of the United Kingdom and with IFRS information, Abdul Wahab and Holland (2015) find that on average, net income surpasses taxable income for the years 2005-2010, except for the year 2009.

2.3 Rules for the financial presentation of income tax

According to IAS 12, completed by other standards, the calculation of current and deferred taxes should be materialized in the disclosure of information, such as:

- in the balance sheet: current tax assets and liabilities, deferred tax assets and liabilities (the latter in non-current elements);
- in the income statement: the tax expense or income connected to the accounting income generated by current operations; income from discontinued operations must be entered in a single line in the income statement, net of tax (IFRS 5);
- in the cash-flow statement; paid income tax must be disclosed separately, in operational cash flows (IAS 7);
- in notes: the elements of the tax expense/income (current tax, deferred tax, adjustments concerning the previous fiscal years or rate changes etc.); the total amount of taxes directly recognized in equity; an explanation (reconciliation) of the relation between tax expense and pre-tax income;

the amount of temporary deductible differences, fiscal losses and tax credits for which the liability of deferred tax has not been recognized etc.

A further obligation concerning the disclosure of tax-related information is mentioned in IFRS 8 *Operational sectors* – the tax expense or income by each identified sector. Leung and Verriest (2015) notice that the decision to recognize income taxes by sector may be influenced by the tendency of company management to hide tax sources, so as to avoid too much fiscal transparency.

2.4 The role of deferred taxes

The recognition of deferred tax liabilities is allowed only to the extent that "it is probable that the entity will have sufficient taxable profit relating to the same taxation authority and the same taxable entity, in the same period as the reversal of the deductible temporary difference (or during periods into which a tax loss arising from the deferred tax asset can be carried back or forward)". This rule imposed by IAS 12 highlights the observance of the accounting principle of the conservatism – a gain is recognized as such only if it is estimated that it will be realized. This is not exactly the historical meaning of the accounting conservatism (which does not accept the recognition of probable gains), but the IFRS are not reputed for their orientation towards the classical interpretation which forbids all over-evaluation of assets *et al.*l under-evaluation of liabilities[1]. Thus, accounting research is oriented towards the measure of the prudence with which entities approach deferred taxes, that is the scope of the accounting recognition of deferred tax liabilities. Hellman (2008) finds that by the affordances that it provides for the accounting recognition of deferred tax liabilities, IAS 12 leads to more opportunities for *temporary conservatism* and reduces *consistent conservatism*[2]. Azmi and Mahzan (2009) notice that Malaysia is characterized by a high degree of prudence in enforcing IAS 12.

The impact of taxes on declared income was analyzed including from the point of view of affordances for earnings management. Dhaliwal *et al.* (2004) argue that the tax expense is very complex; this complexity offers the possibility to plan the effective tax rate and the estimation of the tax expense supposes significant latitude, due to tax contingencies, to provisions/depreciations, and to tax concessions. Graham *et al.* (2012) propose three approaches to income tax in accounting research: earning management, the association between the differences accounting – taxation and the characteristic features of incomes, value relevance of tax information.

Raedy *et al.* (2011) find that for investors, the detailed presentation of differences between net income and taxable income does not have much more influence than the global presentation of these differences.

3. Methodology and sample

Our analysis is grounded in the IFRS accounting figures published by Romanian companies listed on the Bucharest Stock Exchange – BSE – from 2011 to 2014, but we shall also analyze certain information from the pre-IFRS period (2007-2011: RAS – Romanian accounting Standards). The information become from individual financial statements. We took 2007 as the starting year – the first year when Romania was part of the EU. The RAS applicable in 2007 were in force in 2006 as well, but the available data are more comprehensive beginning with 2007. The year 2011 features twice because for this financial year we have RAS figures (2011 RAS financial statements) and IFRS figures (comparative figures published in IFRS 2012 financial statements). During these years, there were between 78 and 89 companies listed on the BSE. We have finally obtained figures for 75 observations by year, after eliminating companies for which financial statements for all years were not available. The sample comprises 375 RAS observations and 300 IFRS observations. Among these 75 companies, there are 11 operating in the financial sector; in our calculations and interpretations, we shall take them into account. The data were collected manually from financial statements published by listed companies on their websites or on the BSE's website.

We have collected the following information which comes from several parts of financial statements:

- from the balance sheet: total assets, deferred tax liabilities, deferred tax assets;
- from the income statement: income before tax, total tax expense (distributed in current tax and deferred tax), net income, the explicit recognition of the deferred tax expense in the income statement;
- from the cash flow statement: income tax paid;
- from the notes: the disclosure of information on current tax and deferred tax accounting policies, the presence of a specific note for the description of the total tax expense, the presence of a statement of the reconciliation between statutory tax rate and effective tax rate, the form of such a reconciliation, the disclosure of the effective tax rate, the explanation of the difference between theoretical tax and the tax presented in the income statement (especially the number of items and their nature), the presence of a note which analyses deferred tax liabilities and assets and the items presented in this note.

The choice for these variables was strongly influenced by previous studies, Raedy *et al.* (2011), Poterba *et al.* (2011), Ebrahim and Fattah (2015) and especially Kvaal and Nobes (2013).

Starting from our collected data, we have calculated simple indicators, such as:

- the effective tax rate (ETR 1): the total tax expense reported in the income statement divided by income before tax;
- the effective tax rate (ETR 2), retaining the current tax expense (for the IFRS periods), so as to ensure a comparison with the pre-IFRS period;
- the effective tax rate (ETR 3), retaining the income tax paid;
- the difference between income before tax (which is featured in the income statement) and the taxable income reconstituted by dividing the tax expense by the legal tax expense;
- the weight of deferred tax liabilities and assets in the total sum from the balance sheet.

In RAS, obligations to disclose tax information were quite limited:

- there was no obligation for the distinct disclosure of tax assets in the balance sheet, but in the notes;
- in the income statements, there was a single line – the financial year's tax expense;
- in the notes, companies used to supply information on the passage from net income to taxable income, most often on the simplified model of the tax return form.

Since before the IFRS, the accounting of Romanian listed companies did not recognize deferred taxes, we could expect the IFRS to influence significantly the effective taxation rate.

4. Results

We shall present the main results of our study descriptively. The five steps of our presentation bear on the differences between income before tax and reconstituted taxable income, the disclosure and the weight of deferred taxes in the total assets, the disclosure and the sign (expense or income) of deferred taxes in the income statement, the calculation and analysis of actual effective tax rates and, finally, the disclosure in the notes of other tax information.

4.1 Differences between income before tax and taxable income

The income before tax (IBT) is in the income statement, while taxable income (TI) is reconstituted starting from the tax expense, divided by the legal tax rate[3] (Lev & Nissim, 2004; Hanlon, 2005; Donohoe, 2015; Abdul Wahab & Holland, 2015). During our study period (2007-2014), the legal tax rate in Romania was stable, 16%. In a short period of time (April 2009 – September 2010), companies whose

calculated tax was lower than thresholds established by law had to pay a minimum tax depending on their total revenues. This made certain highly unprofitable companies declare current tax, which led to reconstituted tax incomes that stood very far apart from net incomes. On the other hand, among the 675 observations, there are 96 (14.22%) for which the total tax expense is zero – we consider that, in these cases, taxable income is zero or negative and that it is not necessary to be considered when calculating the effective tax rate and differences between accounting income and taxable income. Nevertheless, we have only eliminated 75 of these 96 observations, because for the other 21, accounting income is positive and the gap in relation to taxable income can be explained by important specific elements (reported tax losses, various tax deductions, tax credits). Table 2 features the results of our calculations, first for the entire sample and by separating the two types of differences (IBT>TI vs. IBT<TI); then we eliminated the companies that had paid only the minimum tax in 2009 and 2010. The percentages are obtained in relation to IBT. To make comparable the pre-IFRS periods with IFRS figures, we have done the calculations again (for the IFRS periods) by taking into account only current tax.

Table 2. Evolution in the differences between income before tax (IBT) and the taxable income (TI), for the Romanian listed companies

Year	Differences between IBT and TI, based on current tax expense						Differences between IBT and TI, based on total tax expense (starting with 2011 IFRS)					
	IBT>TI		IBT<TI		Total (absolute values)		IBT>TI		IBT<TI		Total (absolute values)	
	N	%	N	%	N	%	N	%	N	%	N	%
2007 RAS	38	39.70	30	45.24	68	42.15	The numbers are the same as in the current tax situations – there was not deferred taxation in RAS					
2008 RAS	34	46.61	29	55.65	63	50.77						
2009 RAS	27	42.34	47	76.23	74	63.86						
2009 RAS**	21	30.58	34	69.53	55	54.66						
2010 RAS	21	39.75	53	83.06	74	70.77						
2010 RAS**	16	27.64	39	74.77	55	61.06						
2011 RAS	19	43.26	38	59.76	57	54.26						
2011 IFRS	25	39.34	41	63.92	66	54.61	29	33.67	37	64.54	66	50.97
2012 IFRS*	22	40.19	44	72.35	66	61.63	30	45.68	37	58.02	67	52.49

Year	Differences between IBT and TI, based on current tax expense						Differences between IBT and TI, based on total tax expense (starting with 2011 IFRS)					
	IBT>TI		IBT<TI		Total (absolute values)		IBT>TI		IBT<TI		Total (absolute values)	
	N	%	N	%	N	%	N	%	N	%	N	%
2013 IFRS*	22	40.31	46	79.07	68	66.53	28	50.81	40	84.50	68	70.63
2014 IFRS	16	54.03	47	62.39	63	60.27	30	78.49	33	59.90	63	68.75

*Outliers are winsorized at the 5th and, respectively 95th percentiles (Ghosh & Vogt, 2012).
** For 2009 and 2010, the indicators are calculated after the eliminations of observations with a negative net income and a minimum tax paid.

The differences between IBT and TI that we can notice in Table 2 (based on current tax) seem very important for all the years taken into account, both in RAS and in IFRS. If for the period 2007-2011 (RAS) there are two years (2007 and 2008) with more companies having an IBT higher than the TI, for all the other years, the observations with a TI higher than the IBT are many more numerous; there are so many specific elements (taxable reintegration) which lead to current taxes that are higher than calculated taxes based on IBT only. At the same time, the scope of differences in the case in which IBT<TI is, however, much more important than in the situation when IBT>TI. Taking into account deferred taxes does not change much the tendency, but the gap between the IBT>TI and IBT<TI observations diminishes considerably and, in 2014, there is even a more important average value in IBT>TI than in the case of IBT<TI. These results will then be completed by the calculation of the effective tax rates.

The situations in which TI is higher than IBT, with important and significant differences, can point to a low income quality (Lev & Nissim, 2004; Hanlon *et al.*, 2012; Chen & Gavious, 2015). In fact, the level of taxable income is used as a reference in the analysis of the quality of the income of listed entities (Graham *et al.*, 2012). Hanlon (2005) states that entities with significant differences between TI and IT come to disclose less persistent incomes than the other entities. On the other hand, IBT which is higher than TI can be a measure of the manipulation of earnings so as to show better performance (Hanlon & Heitzman, 2010).

4.2 Deferred taxes in the balance sheet

The size and the type of operations of listed companies are such that it is very likely that there would emerge situations in which the book value of certain elements of the balance sheet (assets and liabilities) become different from their tax base. Temporary imposable and deductible differences emerge if tax rules differ from accounting rules in the evaluation of assets and liabilities, amortization,

depreciations, the spreading in time of certain expenses and/or revenues. IAS 12 imposes the compensation of liabilities and assets issuing from deferred taxes if certain conditions are met (the existence of a legally enforceable right to compensate for current tax liabilities and assets and the existence of a same fiscal authority that levies these taxes). Thus, in principle, an entity that has tax assets and liabilities only in relation with a single fiscal authority will recognize either a deferred tax liability or a deferred tax asset in its balance sheet. This is the case of the majority (more than 90%) of Romanian companies which apply the IFRS in their individual accounting – they have to pay income tax to a single Romanian tax authority, so they compensate for deferred tax liabilities and assets, so that in the individual IFRS balance sheets one encounters, quite frequently, either a liability or an asset (Table 3).

Deferred tax assets are the most frequent – they can be encountered in more than half of the observations (58.67%) while liabilities are recognized only in 19.33% cases. But the weight of assets is highly superior to that of liabilities: 4.52% on average versus 2.74%, respectively. This could suggest that in the income statement, deferred tax net income are recognized more frequently, on average, than deferred tax net expenses. If we calculate again after eliminating financial companies, the results are similar: a slight increase in the weight of liabilities and a very slight decrease of the weight of deferred tax assets.

Table 3. Deferred tax assets and liabilities in the balance sheets of Romanians listed companies

Year	Total observations	Deferred tax assets in the balance sheet		Deferred tax liabilities in the balance sheet		Deferred tax assets and liabilities in the balance sheet	
		N	% in total assets	N	% in total assets	N	% in total assets
2011 IFRS	75	13	4.51%	42	2.91%	5	9.38% et 2.63%
2012 IFRS	75	11	5.81%	47	2.58%	5	10.43% et 2.54%
2013 IFRS	75	15	4.61%	43	2.90%	5	12.44% et 2.89%
2014 IFRS	75	19	3.70%	44	5.59%	8	7.28% et 2.75%
Total	**300**	**58**	**4.52%**	**176**	**2.74%**	**23**	**8.54% et 2.71%**

4.3 Deferred tax expense/income in the income statement

In IFRS, tax expense (or income) comprises current tax and deferred tax. The existence of deferred taxes can have a significant influence on the total amount of the tax expense and on the net income of the fiscal year. For the IFRS period 2011-2014, among the 300 observations in our sample, there are 196 which show deferred taxes in the income statement: 69 cases of net deferred tax expense and 127 cases of net deferred tax income (Table 4). In 54 situations deferred taxes are the only ones which are featured – current tax is zero.

A few other observations on the information supplied in Table 4:

- almost one third of the Romanian listed companies recognize losses in IFRS (more precisely 30.66%), while the proportion of unprofitable companies in RAS (2007-2011) is of only 18.93% ; it is true that the periods are not necessarily comparable (even though in RAS one could notice the immediate effects of the 2008 crisis) – this confirms (and extends, with data for several fiscal years), the results of Săcărin (2014) and Istrate (2014) who noticed that the transition to IFRS in 2012 led to a strong decrease in net income for the comparative year 2011;
- the proportion of companies that recognized a current tax (that is an immediate tax liability) is almost the same (68.67%) as the one of beneficiary companies, while before the IFRS, the weight of companies paying annual tax comes to 85.33% (78.13% after the elimination of unprofitable companies that paid the flat tax);
- deferred taxes are recognized in 196 observations out of 300 (65.33%) – for the other companies, either there were no temporary differences, or deductible differences are compensated with taxable differences, or there were no restatements to apply to initial tax liabilities/assets;
- since the first application of IFRS (2011 restated), most companies reach a net deferred tax income, that is probably due to the existence of temporary deductible differences which are higher than taxable differences and/or to they come to recognize fiscal losses; we can notice here a proof of optimism among many companies: for 39 observations, the net deferred tax income is accompanied by fiscal loss for the financial year – the respective companies estimate that their future incomes can allow them to settle these assets.

Table 4. Deferred tax expense/income in the income statement of Romanian listed companies

Year	Total observations		Total tax expense in the income statement**	Current tax expense in the income statement**	Deferred tax in the income statement, from which**		
					Total	Net expense	Net income
2007-2011 RAS	**Total, from which**	**375**	**320**	**320***	n.a.	n.a.	n.a.
	IBT > 0	304	287	287	n.a.	n.a.	n.a.
	IBT < 0	71	33	33*	n.a.	n.a.	n.a.
2011 IFRS	**Total, from which**	**75**	**64**	**54**	**45**	**18**	**27**
	IBT > 0	53	51	49	34	15	19
	IBT < 0	22	13	5	11	3	8

Year	Total observations		Total tax expense in the income statement**	Current tax expense in the income statement**	Deferred tax in the income statement, from which**		
					Total	Net expense	Net income
2012 IFRS	**Total, from which**	**75**	**66**	**52**	**52**	**18**	**34**
	IBT > 0	51	50	48	37	16	21
	IBT < 0	24	16	4	15	2	13
2013 IFRS	**Total, from which**	**75**	**67**	**48**	**54**	**21**	**33**
	IBT > 0	52	51	46	39	16	23
	IBT < 0	23	16	2	15	5	10
2014 IFRS	**Total, from which**	**75**	**63**	**52**	**45**	**12**	**33**
	IBT > 0	52	52	50	35	10	25
	IBT < 0	23	11	2	10	2	8
Total	**Total, from which**	**300**	**260**	**206**	**196**	**69**	**127**
	IBT > 0	208	204	193	145	57	88
	IBT < 0	92	56	13	51	12	39

*From which 27 companies paying the flat tax in 2009 and 2010
** All data represent number of companies.

4.4 Reconciliation of the statutory tax rate and the effective tax rate

IAS 12 imposes the disclosure of a reconciliation between the expense or the net tax income and the income before tax of the financial year. Beginning with 2012, we have to expect that Romanian listed companies disclose such information in notes. In fact, among the 300 valid IFRS observations, this picture of a reconciliation is present in 193 cases (64.33%), the legal tax rate (16% for the entire period) in 160 cases (53.33%), while the effective rate is featured in only 15 cases (2.5%). The elements which explain the difference between legal rate and effective tax rate are, most frequently, recognized in compliance with the outline of tax return. In the 184 cases where we found explanations on the passage from legal rate to effective tax expense, there are between 1 and 8 items (Table 5). The most frequent are very general elements such as *non-deductible expenses*, *non-imposable revenues*, which do not reveal much about the detailed causes of the difference between net income and taxable income. The structure of the information recognized in this note is such that it was impossible for us to differentiate between temporary and permanent differences. We must also recall that even for one and the same company, the format of the recognition in the notes is not similar from one year to another, there are significant differences in recognition between companies, which means that the frequency of the recognition of items must be approached with caution.

Table 5. Items disclosed in the reconciliation of the effective tax expense and the statutory tax expense, by the Romanians listed companies

Items	Frequency
1. Non-deductibles expenses	162
2. Non-imposable revenues	159
3. Sponsoring	68
4. Elements assimilated to taxable revenues	60
5. Deductions related to legal reserves	59
6. Temporary differences	51
7. Others elements*	42
8. Fiscal losses	41
9. Tax credits	25
10. Elements assimilated to deductible expenses	23
11. Tax reductions or tax exemptions	22
12. Accounting depreciation different from fiscal depreciation	16
13. Restatements for the transition to IFRS	13
14. Revaluation of fixed assets	12
15. Impairments	9
16. Special tax rules for dividends	8
17. Provisions	7
18. Fines	6

*Raedy et al (2011) found that the items *Others* is the most present between the 22+19= 41 items identified in the financial statements of more than 600 American companies in the 1993-2007 period.

Some other information required by IAS 12 is the separation of tax expense in current tax expense and deferred tax expense/income. In most observations (231 out of 300), we notice a preference for this separation in the notes - only 61 entities having chosen to do it directly in the income statement.

IAS 12 rules impose the calculation of the effective tax rate (ETR) by considering total tax expense and income before tax, if it is positive (ETR 1). The figures calculated for the observations in our sample are presented in Table 6. The legal rate is 16% for the entire analyzed period. In order to better grasp the impact of differences between accounting and taxation concerning income measurement and to ensure a cross-sectional comparability throughout the studied period, we have chosen to present two other indicators, simultaneously: the effective tax rate calculated on the basis of the current tax expense – ETR 2 – and the effective tax rate calculated starting from the income tax paid during the fiscal year (ETR 3). These three effective tax rates are used by Donohoe (2015) who, in order to calculate them, cumulates data for three fiscal years and eliminates observations with a negative income. Dyreng *et al.* (2008) cumulate taxes paid on periods going up to 10 years so as to compare them with cumulated income for the same period, so as to obtain more suggestive results in the identification and measure of tax

evasion. The cumulus can be explained easily when we compare ETR 1 or ETR 2 with ETR 3 – in fact, part of the tax is paid in the fiscal year following the one in which income was obtained and so cumulated figures can be more representative. In a first panel in Table 6, we shall calculate by year, and in the second and third panel, we present indicators obtained after the aggregation of tax expenses and incomes for 5 fiscal years in RAS and for 4 fiscal years in IFRS. For ETR 3, the information concerning tax paid comes from cash-flow statements; we eliminated all observations for which this information was not available or for which there was no income tax paid. For the same indicator, when there was paid tax and negative income, we chose to calculate by taking income in its absolute value.

The first commentary on the indicators calculated in Table 6 have to do with the fact that the annual effective tax rate for beneficiary companies is higher than the legal Romanian rate of 16%, except for ETR 1 in 2007 RAS and ETR 3 in 2011 IFRS and in data cumulated in RAS. This can lead us to believe that fiscal rules are very constraining in what concerns the deductibility of recognized expenses and/or that listed Romanian companies are not very involved in fiscal optimization operations that could decrease total tax expense concerning income tax. In fact, if we compare these indicators with the situation in the United States, for instance, we notice a very net difference – GAO (2013) finds an effective tax rate for American companies far behind the legal rate, while for EU countries, the effective tax rates (for the non-financial sector) are, in general, lower than legal rates (EU, 2015, p. 146).

In panels 2 and 3 from Table 6, we have cumulated income before tax, the (total and current) tax expense and the tax paid by each listed company, for 5 and, respectively, 4 fiscal years. Given the compensations between fiscal years, the slightly delayed tax payment and the gradual elimination of temporary differences, we believe that the results obtained starting from these cumulated data are more robust than those in panel 1 in Table 6. In fact, the differences noticed between annual ETRs and cumulated ETRs, by considering only income before taxes (annual, respectively cumulated) are almost null for ETR 1 and ETR 2. The situation of ETR 3 is slightly contrasted and it is due probably to the fact that the respective companies have not paid the tax that they have declared.

In an initial sample we kept 11 companies whose activities are essentially financial. In order to consider the specific features of the financial sector (like most studies), we have recalculated by eliminating financial companies: the vast majority of average effective tax rates are slightly higher than those calculated for the entire sample, which can suggest that non-financial companies have less affordances to manage taxable income. However, the differences are not significant.

Table 6. Effective tax rate for Romanian listed companies

Year	Observations	ETR 1	ETR 2	ETR 3	
				N	%
Panel 1 – By year, IBT > 0					
2007 RAS	68	15.74%	15.74%	38	20.71%
2008 RAS	61	16.83%	16.83%	38	19.44%
2009 RAS	60	19.22%	19.22%	48	17.25%
2010 RAS	58	22.06%	22.06%	53	16.03%
2011 RAS	57	20.53%	20.53%	46	16.84%
Total RAS	**304**	**18.75%**	**18.75%**	**223**	**17.80%**
2011 IFRS	53	17.41%	17.64%	46	15.93%
2012 IFRS	51	16.96%	18.02%	48	18.48%
2013 IFRS	52	19.36%	20.01%	39	21.07%
2014 IFRS	52	17.59%	19.27%	42	19.78%
Total IFRS	**208**	**17.83%**	**18.73%**	**175**	**18.70%**
Panel 2 – Cumulated data for 5 years (RAS) and 4 years (IFRS) – total observations					
2007-2011 RAS	375 :5=75	12.31%	11.37%	75	7.56%
2011-2014 IFRS	300 :4=75	12.30%	10.62%	75	8.88%
Panel 3 – Cumulated data for 5 years (RAS) and 4 years (IFRS) –observations with IBT > 0					
2007-2011 NCR	55	19.26%	18.91%	46	15.57%
2011-2014 IFRS	48	16.98%	18.64%	42	16.91%

Outliers were winsorized at the 5th and 95th percentile.

To compare these results with those of other Romanian companies, we have used data published by companies listed on an alternative market hosted by the BVB as well – the AeRo Component – launched in the early 2015 and on which listed companies are generally small-sized. Since this market (AeRo) is not considered regulated, companies listed on it are not bound to enforce IFRS – they contend themselves with RAS and so they only publish information on current tax. For the fiscal years 2010-2014, we could obtain 769 valid observations (positive income before tax and tax expense): 127 for 2010, 169 for 2011, 159 for 2012, 152 for 2013 and 162 for 2014. The effective tax rate (ETR 2) is decreasing (from 25.47% in 2010 to 18.73% in 2014), but the average for the five fiscal years is 20.73%, very close to the average of companies listed on the regulated market. When we recalculate with data cumulated for 5 RAS fiscal years (2010-2014), we obtained 23.55% by retaining only positive cumulated income (versus 11.16% for all 259 observations).

4.5 Disclosure on temporary differences sources

IAS 12 also imposes the disclosure of the main sources of temporary differences that led to the emergence of deferred tax liabilities and assets. We must first point out that, for the Romanian listed companies, in only 160 observations (out of 300) can one find such information in the notes. In Table 7, we have centralized the main elements stated by the Romanian listed companies which have enforced IFRS in their individual accounting.

Table 7. Assets and liabilities generating temporary differences and deferred income tax for the Romanian listed companies

Item	Frequency
Non-current assets	145
Receivables	82
Provisions	69
Financial instruments	59
Inventories	52
Pensions obligations	38
Tax loses	35
Other liabilities	28
Investment properties	17
Prepaid expenses	14
Legal reserves	8
Prepaid revenues	6
IFRS restatements	6
Constructions contracts	6
Tax credits	6
Loans	4
Biological assets	1

Fixed assets are the main source of temporal differences, mainly because of depreciation methods, of cost components, of revaluation and impairment rules. For the other elements of the assets and liabilities that are featured in Table 7, the sources of temporary differences come mainly from accounting evaluation rules which are not always fiscally recognized (depreciations, the use of fair value in accounting, the accounting recognition of certain provisions that are not recognized fiscally).

5. Conclusion

The passage to IFRS in Europe has generated numerous studies on their effects in terms of the information reported in financial statements. Lyle *et al.* (2008) find, in the responses received from persons involved in the transition to the IFRS (preparers, auditors and users), that these standards contribute to more credibility and reliability in financial statements, but they increase the complexity of financial reporting, which makes the process of the elaboration and analysis of accounting and financial information more difficult. In fact, complexity is a recurrent issue in studies on the impact of IFRS (Stent *et al.*, 2015). We agree with the authors who state that part of this complexity comes from very complex rules for the recognition of deferred taxes.

Our study aims to identify the main consequences of the transition to IFRS of Romanian listed companies, on the disclosure of information concerning taxes on

benefits. We have retained in our sample the individual financial statements of 75 entities from a period which starts in 2007 (the year when Romania joined the EU) and ends in 2014 (the last year for which there are available data); in total, there are 375 observations with figures according to Romanian accounting standards and 300 observations according to IFRS; for the year 2011 there are two series of numbers in RAS (taken from financial statements from 2011) and in IFRS (taken from financial statements from 2012 – the first in IFRS).

Several interesting conclusions can be drawn from our descriptive analysis. First, the reconstitution of taxable income, starting from the tax expense, leads to very important differences between this taxable income and the accounting income before tax, both in RAS and in IFRS. These figures can testify to the significant gap between accounting rules and tax rules, which confirms, to a certain extent, an evolution towards an increasingly more important *de facto* disconnection between accounting and taxation. At the same time, following the literature, we can argue that these differences signal the low quality of the accounting income. Second, the enforcement of IFRS beginning with 2012 has led to the emergence, in the balance sheets of Romanian listed companies, of deferred tax liabilities and/or assets. There are more companies which recognize assets, but the weight of these assets, on average, is less important that the weight of liabilities. Third, the deferred tax expenses/incomes are present in more than 65% of the companies in our sample; the effective tax rate calculated starting from figures published in the profit and loss account is systematically higher than the legal rate of 16% in Romania, for the three formulas that we have used (by retaining, successively, the total tax expense, the current tax expense and the paid tax). Finally, the information supplied in the notes on the sources of deferred taxes allows us to notice that non-current assets are the main elements that generate temporary differences.

The results of the paper could be compared with the situation in other countries as to obtain an image of the relationship between accounting and taxation at the EU level or, at least, at the level of Central and Eastern European countries.

Our study has several limitations. First, it is essentially descriptive. Second, the sample is narrow – we could extend it to companies listed on other East-European markets. Also, we have not connected tax information disclosure to variables such as industry, company size, the ownership (including the presence of the State as a shareholder), the composition of the board, the audit quality and the audit cost, the presence in tax heavens. All these limitations can represent just as many directions for future research. It would be equally possible to analyze the evolution of the direction of differences between accounting income and taxable income for each company (positive and/or negative differences).

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Notes

[1] In fact, in the current conceptual framework of the IASB, the qualitative characteristic of prudence is not featured explicitly any more, which leaves the door open for the accounting recognition of probable gains. IFRS take advantage of this and they allow or impose the recognition of such revenues in a large number of cases (investment properties, biological assets and agricultural produce, financial instruments). Hellman (2008) notices that in many Western countries, before the arrival of the IFRS (and especially of IAS 12), deferred tax asset, which corresponded to a reported fiscal loss, was not recognized.

[2] In explaining the two forms of conservatism, Hellman (2008) argues that *temporary conservatism* consists in the temporary application of the prudence principle, that is changes in accounting estimates which lead to the temporary reduction of equity; *consistent conservatism* is the choice of the accounting method which leads to the lowest evaluation of equity.

[3] This formula is not perfect, due to differences coming from fiscal credits, tax cuts and other elements which do not impact net or fiscal products and charges.