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FINANCIAL RISK EVALUATION IN THE CONTEXT OF INTERNATIONAL ACCOUNTING NORMALIZATION

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Abstract *Within the framework of the normalization phenomenon, the quality of the* ***accounting information*** *has improved as the companies have stepped up with their competitiveness parameters; compared to the opponents on the local and international markets by means of the accounting information they have access to. The main explanation of the phenomena of* ***normalization****, harmonization, convergence, internationalization is the augmentation of the global processes of the international markets, capital and the national economies that verge on to building a single system from the perspective of the global economic development. The exposure on the financial markets has an impact upon most organizations, either direct or indirect. When an organization is visible on the financial markets, it is very likely to have losses but also gains or profit. This specific exposure is the venue to strategic or competitive[1]benefits.*

Key words:
Accounting normalization, financial situations, convergence, International Standards of Accounting and Reporting, financial risk

JEL Codes:
M41, G32

1. Introduction

The object and target of the accounting normalization are the implementation of identical accounting norms in the same geographic and political space and building homogeneous accounting practices,[2] while according to C. Perochon "the object of the accounting normalization can be drawn attention to by the financial accounts or the charts of accounts."[3] An important step in reaching a higher stability on the financial markets is to promote a single global set of accounting standards.[4]

2. Approaching the Financial Risk within the International Norms of Financial Reporting

In compliance with the conceptual framework of IFRS,[5] the purpose of the financial accounts is to provide information about the financial position, performance and the changes in the financial position, useful in the decision-making process. The information pertinent to the *financial risks* is not a target per se of the financial accounts, as IASB stipulates. But they are factors with a direct involvement upon the financial position and performance. A correct management evaluation helps with the strengthening of the financial position and to increasing performance, which are essential matters for the users of the financial accounts.

The importance of managing the financial risks is emphasized by the international standards via issuing standards to assist the users of the information, thanks to the fact that the evaluation and management techniques have evolved in the recent years.

From their perspective, the companies implementing them are supposed to report quantity- and quality-related information about certain financial risks which they are exposed to. The standard that regulates these requests is IFRS7 Financial instruments – disclosures, which became effective as of January 1st, 2007. Certain requirements included in it are partly replacements for the IAS32, while others (such as the quantity and quality information concerning the financial risks) are new and have turned into a challenge for many companies. To the best compliance with the requirements in this standard, the companies are supposed to:[6]

- be aware of the fact that the standard calls for information on how the results would have been influenced provided that the market conditions (for example, the interest level, the exchange rate, the merchandise, the capitals) had changed from the reasonable possible values to the values on the reporting day;
- evaluate the need for developing new systems and processes of collecting information requested by the demanding requirements of IFRS7;

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- verify whether the systems used for generating the necessary information have an appropriate level of internal control so as to be used in the financial reporting, including the audit;
- be aware of the fact that IFRS enforces the presentation of information used by the company management for risk measurement and management;
- devise a communication plan that clearly links the strategy of holding the financial instruments, the manner in which the risks associated to them are managed, as well as how they are incorporated in the general strategy of building value.

The users of the financial accounts are interested in the information on the risks derived from the financial instruments to which the entities and used techniques are exposed to while identifying, evaluating, monitoring and controlling such risks. The IFRS requirements on the risks reporting are as follows:

IFRS 7 "Financial instruments: disclosures" applies to all the risks inferred from all the financial instruments, with a few exceptions. It became effective for the annual periods starting with January 1st, 2007 or after that date. It is recommended to apply prior to that date.

One of the objectives of this standard is to "request the entities to provide in their financial accounts presentation of information that will allow the users to evaluate: [...] the nature and the extent of the *risks* deriving from those financial instruments to which the entity is exposed during the respective period and on the reporting day, as well as the manner in which the entity manages such risks."[7] The risks that this standard refers to include, but are not limited to the risk of credit, risk of liquidity and the market risk (fig. 1).

For each risk generated by the financial instruments, the standard compels the companies to present certain quality information (risk exposure, objectives, strategies, the risk management processes and the methods in use) and also quantity information (data regarding the exposure at the end of the reporting period, specific information for each type of risk).

The standard gives the possibility to the company to perform an analysis of the market risk sensitivity by using VaR (value at risk) or other own methods that will reflect the interdependencies among the risk variables. This sensitivity analysis is one of the most imperative requirements set by IFRS7. This includes an analysis of the financial risks inherent to the financial instruments, including a presentation for each type of risk and its effects upon the profit or loss. The methods and the hypotheses used in the analysis above need to be explained, and all the changes versus the anterior period and all the reasons have to be also submitted. VaR can be a sure replacement of this sensitivity analysis, as already mentioned.

IAS39 "Financial instruments: recognition and measurement" outlines the coverage against the risks, while introducing the instruments, the elements and also the coverage accounting. The risk coverage involves the assignment of a financial instrument, derivative or non-derivative, as a redress for the variation of the fair value or of the hedging cash flows.

The requirements of the international standards to report certain risk-related information are the result of the changes occurring in the quality of the accounting information, mainly the increase in the accuracy of measurements.

The information that needs reporting, in terms of such requirements, is different from the data in the financial accounts and relies on the management rationale, thus becoming subjective. This type of reporting provides a useful picture of the manner in which the entity deals and manages the risk and results into information of a predictive value.

Fig.1. Risk reporting in IFRS

Source: personal adaptation

IFRS can be noticed to regard the credit risk analysis and the market risk's as essential as the liquidity risk analysis. The purpose of the requests is to inform the *users of the financial accounts* and help them in the decision-making process. Providing pertinent information is a major challenge for companies, since the annual reports are the main channel of communicating useful information that is the guide for the decisions about investments, credits and other issues.

3. The Risks of Conversion to IFRS

Coming from an opposite perspective, the conversion to IFRS has its own risks by its very nature.

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In fact, they generate *operational risks*, by the possibility of having errors, difficulties in implementing or interpretation – the erroneous application of the standards can lead to a global financial risk, with a significant impact on the information quality, comparability in results and the measurements of the analysts.

The operational risks that can occur when an entity applies the international standards can be reduced to minimum by a well performed risk management and better yet by the involvement of this risk into the plan of conversion from the national to the international standards. A study conducted by Delloitte has revealed that the most common weaknesses in the management of this type of project are:

- the underestimation of the resources to be required;
- absence of understanding of the impact upon the information technology and finance;
- a company structure lacking efficiency;
- the expectations and roles that are not clearly formulated.[8]

Likewise, the acknowledgment of the existence of weaknesses is a first step in consolidating the plan of conversion to IFRS. The establishment of the areas which the international standards have an impact upon – the reporting, the processes and systems, taxes, legal, internal control, the relations with the investors, the training, the project management – it also helps to discern the extent of the conversion and attracts the attention towards the areas that are called in question.

The anticipation of the potential risks and the development of response plans to these, plans that will prioritize the risk in terms of impact and vulnerability lead to an efficient risk management, especially if we consider that their effects go beyond the accounting sector.

In the risk management, an important role is played by the *audit department* of the companies, which is responsible for providing an objective assurance and a proactive monitoring of the potential risks that the company can run into. Some of the key areas where the audit department should involve are: the internal control exerted upon the financial reporting, the post-compliance events.

4. Conclusions

The current trend is of *accounting normalization,* but there will be more accounting models, with their own specificity until the international standards of financial reporting are globally adopted. While correlating with features of every accounting model with the evaluation methods of the financial risk, the conclusion to be drawn is that the financing model and the people interested in the financial accounts of the companies have a special impact upon the models above. The *normalized accounting model* is no exception from this rule, but it greatly focuses on the *risk management* and presentation of their impact, which proves to us that there is a sense of awareness in the importance of their pursuit.

This is how an explanation is found for the individual companies that mostly use the continental and the Anglo-Saxon accounting models, where each of them focuses on a certain financial risk, namely the credit risk and the market risk, due to the influence of the financing pattern.

In Romania, the individual companies whose securities are transacted on a regulated market need to compile financial accounts that comply with IFRS. As a conclusion, distinct accounting models and a different prioritization of the financial risks are being identified for such companies.

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