Effects of IPSAS Adoption in Public Institutions in Romania on the Quality of Financial Reporting

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Abstract

This paper examines the practical improvement on the quality of financial reporting in the Romanian public institutions after implementing IPSAS. To test our hypothesis, we used a questionnaire addressed to the accounting professionals from the local public administration, in which 164 respondents participated. In this revision, we use a linear regression analysis method to examine the relationship between the implementation of IPSAS and the quality of financial reporting in the Romanian public institutions. The introduction of IPSAS, as demonstrated by empirical studies, is significantly positively related to the quality of financial reporting in the Romanian public institutions. The findings of this research recommend that regulators take appropriate measures to ensure compliance by those responsible for the preparation of financial statements of public sector entities. Efforts should also be made to improve the quality of disclosure of relevant financial reports to help users make beneficial economic decisions.

⊃ Introduction

Accounting standards are set in countries around the word taking into account the specific circumstances of individuals. Cross-border transactions fuel economic growth and increased cooperation between countries around the world (Ijeoma & Oghoghomeh, 2014). Due to this development, there is a greater need for standardization, comparability and transparency in terms of the fundamental standards for the preparation of the financial reports of public institutions, so that they keep on being relevant and provide the same information to users around the world (Tawiah & Soobaroyen, 2022). Public institutions refer to organisations that are controlled by the public through elected persons, known as public administrations (Acho, 2014). Public institutions refer to all organisations that are established, run and funded by the government on behalf of the public.

International Public Sector Accounting Standards Board (IPSASB) normalizes the accounting accomplishments of public sector entities, with the exclusion of government enterprises (Heald, 2003). International Public Sector Accounting Standards (IPSAS) are issued by the IPSASB for public administration accounting in response to calls for superior financial transparency, accountability and value relevance (Yusuf *et al.*, 2021). Since IPSAS are recognized and accepted by international public administrations, it is recommended to assume and harmonize national accounting standards in accordance with international best practices. Thus, IPSAS deserves the consideration

of public administration regulators, policymakers, practitioners and academia equally (Toudas *et al.*, 2013). The research constraint identified in this research is, first of all, poor economical implementation and lack of accountability in financial reporting (Ibanichuka & James, 2014). In addition, according to Transparency International (https://www.transparency.org/en/cpi/2021/index/rou), Romania ranked 66th out of 180 countries on the corruption perception index (CPI) on transparency and accountability of the public sector.

There is a high level of public debt in diverse sectors. For that reason, high-quality financial reporting is needed to prudently account for public finances.

The main objectives of this research are the following:
● analysis of the overall influence of IPSAS implementation on the quality of financial reporting in Romanian public institutions;
● analysis of the extent to which the implementation of IPSAS has developed the quality of the elements of financial reporting in terms of accountability, transparency, comparability and relevance in the Romanian public institutions.

⊃ Literature review

■ Romanian public institutions and the implementation of IPSAS

IPSAS is a set of accounting principles issued by IPSASB for use by public institutions around the world in the preparation of financial statements (International Public Sector Accounting Standards Board, 2015). Accrual IPSAS are based on International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB), where the requirements of those principles are applicable to the public sector. They also deal with issues related to public sector specific financial reporting that are not addressed in the IFRS.

PricewaterhouseCoopers (2012) recognized that the IPSAS objective is to serve the public interest by increasing quality financial reporting standards in the public sector and by warranting the convergence of both national and international standards, therefore increasing the quality and uniformity of financial reporting worldwide.

In Romania, the implementation of IPSAS and the transition to accrual accounting was not done all at once, but in several **stages**, thus:

✓ **Phase I:** Development of a new chart of accounts, of new methodologies, principles and accounting policies, and of a new budget classification – stage completed at the end of 2006.

✓ **Phase II:** Experimental implementation of the new regulations in a significant number of public institutions of central and local supervision – the regulations of Order of the Minister of Public Finance No. 1746/2002, which includes the Methodological Norms on the organization and management of the accounting of public institutions, the Chart of Accounts for public institutions and the monograph of the main operations in accounting, applied in the first semester of 2003 to 10 principal authorising officers and approximately 100 institutions subordinated to them.

✓ **Phase III:** Improving the regulations developed as a result of the conclusions drawn from the pilot phase (second semester 2003 – fourth semester 2005) through the implementation of two projects (Ministry of Public Finance, 2002):
● Twinning light project RO 01/IB/FI-09 TL "Improving the organisation and performance of the public accounting system".
● Twinning project RO 02/IB/FI-04 "Improving the organisation and performance of the public accounting system".

✓ **Phase IV:** Approval, publication of the new regulations and their implementation from the 1st of November 2005 (Order of the Minister of Public Finance No. 1461/2004). Due to the lack of necessary logistics and workforce, it was decided to switch to accrual accounting of all Romanian public institutions starting with the 1st of January 2006.

✓ **Phase V:** The implementation of the Stability and Growth Pact with the aim of increasing budgetary discipline and promoting the stability of the economy takes the form of transposing the Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States into the Romanian legislation, which provides rules applicable to the public accounting, financial accounting and statistical reporting systems.

The transposition of IPSAS and European directives into the accounting of public institutions was achieved through:
- the implementation of the COFOG 3 account system according to Order of the Minister of Public Finance No. 2021/2013;
- the transition of the execution of the income and expenditure budget to the COFOG 3 system according to Order of the Minister Delegate for Budget No. 720/2014;
- holding the certificate attesting the knowledge of the European System of Accounts of the heads of the financial accounting parameters;
- the creation of an information system for reporting the budget execution and financial statements – ForexeBug, an IT program with internet access by means of which public institutions electronically report the financial statements related to the patrimonial and budgetary accounting.

The ForexeBug reporting system has the role of responding to the needs of transparency and publicity of the financial statements and of the budgetary data of public institutions in accordance with the European regulations, in order to increase the degree of trust of the data collected through cross-validations between ForexeBug records and financial records of public institutions.

■ **Adoption of IPSAS and quality of financial reporting**

International Federation of Accountants (IFAC) is the global organization that holds the board that develops IPSAS standards as principles to help public institutions around the world in reporting high-quality financial statements. The IFAC encouraged government and public sector organisations to adopt an accrual accounting basis for their general-purpose financial statements (Oyewobu & Salawu, 2019).

✓ *IPSAS implementation and responsibility*

The shift to accrual accounting was initiated by developed countries as part of the public sector reform (Hassan, 2013). Thus, the annual financial statements play a significant role in the responsibility of public institutions towards citizens and their elected representatives (Hughes, 2013), because cash-based accounting did not make it possible to obtain the information needed to provide better support for resource planning and management and, in general, for decision-making processes, allowing for greater accountability, even between different entities (Christiaens *et al.*, 2010). Thus, IPSAS have become de facto international benchmarks for assessing accounting practices in public institutions and a tool for measuring global responsibility (Chan, 2006).

✓ *IPSAS implementation and transparency*

According to Okolieaboh (2013), IPSAS is a collection of public sector accounting standards issued by the International Public Sector Accounting Standards Board, developed after International Financial Reporting Standards, their private sector predecessor. IPSAS standards have been designed with the aim of ensuring transparency in the financial reporting of public institutions in all fields of activity and in all jurisdictions. The conceptual basis of once more established principles is similar to the IFRS basis used in the private sector to increase transparency towards citizens (Gomes *et al.*, 2019).

✓ *IPSAS implementation and value relevance*

According to Ijeoma and Oghoghomeh (2014), the implementation of IPSAS must be relevant for users of financial statements in public institutions, such as taxpayers, members of parliaments, creditors, suppliers

and employees in the media, but also in other public institutions. Financial statements prepared in accordance with IPSAS shall present fairly the financial position, financial performance and cash flows of an entity, so that users of such financial statements can make relevant and timely decisions.

✓ *IPSAS implementation and comparability*

Okoh and Ohwoyibo (2010) are of the opinion that the need for comparability reflects the need for public institutions to have a uniform set of financial statements. This uniformity will impose a greater demand for accountability on civil servants who manage the relationship with the users of financial statements. This will further strengthen the public-private partnership due to the comparability of financial reporting of public sector entities.

✓ *IPSAS implementation and faithful representation*

The implementation of IPSAS will pave the way for the full disclosure of financial information that will serve the need of different users. Ozugbo (2009) also stressed that the implementation of IPSAS would eliminate the partial financial reporting currently observed in most public institutions. Full representation will ensure the quality of financial reporting in terms of its international content, relevance and competitiveness.

⊃ **Preliminary studies on the implementation of IPSAS and the quality of financial reporting**

Mhaka (2014) conducted a cost-benefit analysis of the implementation of IPSAS in Zimbabwe through a comparative research of the current cash accounting base and the proposed IPSAS-based accounting reporting. The research went further to unearth the challenges in cash-based accounting that will be solved by adopting IPSAS-based standards. The author considers that the implementation of IPSAS would change the financial reporting base from prevailing cash accounting to IPSAS-based cash accounting and accrual accounting. The research provided that this facilitates the reconciliation of budgeted and actual results, as it would be necessary to align budgetary preparation with full build-up, as well as to strengthen existing capacity that allows reporting and comparing the budget with the actual results (Ilie & Miose, 2012). It would also allow the improvement of results-based budgeting.

Christiaens *et al.* (2010) analyze the extent to which European governments have adopted IPSAS accrual accounting and how the different stages of implementation are explained, through a survey of experts in the field. The authors pointed out that there is no single approach to the process of adopting IPSAS and accrual accounting and there are still governments that do use IPSAS, but cash accounting is still rarely used. Most local and central governments adopt accrual accounting without considering IPSAS, which can be explained by the need for transparency and efficiency. The research exposed that the highest motivation for adopting IPSAS is that it offers specific exclusivity and know-how and argues that the success of IPSAS largely depends on establishing its strengths and highlighting the necessary expectations to be met.

Ijeoma and Oghoghomeh (2014) examine the expectations, benefits and challenges of adopting International Public Sector Accounting Standards in Nigeria. The research improves the primary source of data to generate the data of interest, and the statistical tools used were the Chi-square test, the Kruskal-Wallis test and the descriptive analysis. Conclusions suggest that the IPSAS implementation will increase accountability and transparency in the public sector in Nigeria.

Centred on previous research, it was found that the implementation of IPSAS would improve international comparability and best practices. We also took into account that the implementation of standards based on IPSAS will allow the provision of more important information for decision-makers and will improve the quality of the financial reporting system in Romania.

Alshujairi (2014) examines the financial reporting system in Iraq and the need to improve the public accounting system by adopting an IPSAS-based accrual accounting. The research used a qualitative methodology through a questionnaire to obtain the necessary data, the result of the survey showing that a large number of respondents believe that the Iraqi government accounting system needs an important reform, citing as the main reason the corruption. The result also underlines the need to improve the transparency, the quality of the accounting system and, respectively, the accountability of public institutions towards citizens. In this context, the accounting of Iraqi public institutions should adopt IPSAS, as accrual accounting provides better assurance of financial integrity compared to cash or modified cash-based accounting, a reference point for assessing and improving the accounting of public institutions in the world, improves the transparency of information and complies with international reporting standards. The lack of high competence and qualification in accounting of human resources is regarded as a huge difficulty in applying IPSAS to the accounting system of the Iraqi government.

Atuilik (2014) analyzes the connection between the statement of the implementation of IPSAS and the stages of corruption in developing and developed countries. The research used a quasi-experimental examination in which the corruption perception index compiled by Transparency International was used to measure opinions of corruption. It is concluded that perceptions of corruption in developed countries that have declared the implementation of IPSAS are not significantly different from those in developed countries that have not yet declared the implementation of IPSAS. The results are developmentally opposite, with some degree of difference. The author noted that developed country public administration may not have anticipated that adopting IPSAS would definitely improve their corruption perception ratings, while developing country governments could expect their corruption perception ratings to improve through the implementation of IPSAS. This is according to the research of Alshujairi (2014), which makes available evidence that developing countries are heavily affected by corruption.

Trang (2012) conducted a similar research examining whether or not the accounts of the Vietnamese government should operate IPSAS and describing the extent to which they can be applied within Vietnam's present settings, and evaluating in detail the usefulness and feasibility of IPSAS for the accounting and financial statements of the Vietnamese government. The author argued that the shift in accounting systems from cash to an accrual base is usually an element of a broader set of their reforms, these changes are increased in delegation, departments are directed to provide a service to citizens rather than comply with established rules, and there is better transparency of the public sector in reporting and measuring performance.

⮊ **Research hypothesis**

The central objective of this research is to study the impact of the implementation of IPSAS on the quality of financial reporting in the Romanian public institutions. The hypothesis of this research is that the implementation of IPSAS will increase the quality of financial reporting in the Romanian public institutions.

Udeh and Sopekan (2015) examine the implementation of IPSAS and the quality of public sector reporting. It was noted that the implementation of IPSAS is expected to improve the quality of public sector financial reporting in Nigeria. The research states that accrual-based IPSAS has the ability to improve financial reporting compared to cash-based accounting.

Based on the revised literature, this research thus predicts that:

H1: The implementation of IPSAS will not significantly improve the quality of financial reporting in the Romanian public institutions.

This research takes on the theory of the agency as it underlies the relationship between two parties, the principal (taxpayers) and the administrators (public institutions) (Donaldson & Davis, 1991). The theory of the agency is based on the quality of the relationship between the principal and the administrator and the ideals of the organization (Corbetta & Salvato, 2004). The hypothesis of the theory is that the relationship between

principal and administrator is based on choice. Once both parties choose to behave as administrators and put the interest of the principal first, the theory thus suggests a positive impact on performance, since both parties work towards a common goal (Eddleston *et al.*, 2007).

⊃ Methodology

The research design method was used to collect data through the use of the questionnaire. All employees in the accounting of the municipalities' mayoralties were invited to participate in the completion of this questionnaire. The invitation was sent through the Association of Municipalities in Romania, a legal, non-governmental organization of private law, established with the purpose of protecting the common interests of local public administration authorities and managing the public needs in the interest of local communities. The association includes 109 members, respectively all 103 municipalities in Romania and the six sectors of Bucharest. The total population of this research is estimated at 350 people, while the sample size is 190 people. Taro Yamani's formula was used to obtain the model size for the research. The questionnaire was available from October to December 2022, and the interpretation and processing of the data was carried out in January-February 2023.

Taro Yamani's formula is the following:

$$n = N/[1 + N(e)^2]$$

where:
n = sample size;
N = population;
e = error limit (0.05 based on 95% confidence level).

So, $n = 350/[1 + 350(0.05)^2] = 350/1.875 = 186.66$

Based on the above calculation, the sample size of 190 with an error limit of 5% is considered appropriate for this research. Of the sample's 190-person size, 164 people replied to the questionnaire, which is a 86% response rate, while 14% is the bounce rate.

The questionnaire was built using a five-point Likert scale and was divided into two sections:
● section A contains the personal information of respondents;
● section B deals with questions relating to the hypothesis.

The data collected was analyzed using both descriptive and inferential statistics.

The simple linear regression method of smallest squares was used in this research as a statistical method of analyzing the data collected. This research adopts this method because it allows the adjusted coefficient of determination (adjusted R^2) as a unit of measurement of the relationship between dependent variables (implementation of IPSAS) and independent variables (quality of financial reporting). The Statistical Package for the Social Sciences (SPSS) was used to analyze the data collected for the research.

⊃ Model specifications

The basis for this specification of the model is represented by the theoretical framework that tries to explain the relationship between the implementation of IPSAS and the quality of financial reporting in the Romanian public institutions. This is done from the perception of the agency's theory, which considers the implementation of IPSAS and the quality of financial reporting as variables affecting the national interest, taking into account its effects on all public stakeholders.

Implementation of IPSAS = QFR

where:
QFR = quality of financial reporting.

Consequently, the implementation of IPSAS can be represented as follows:

Implementation of IPSAS = f(QFR) (I)

Assuming a linear relationship, we can rewrite all of the above equations (I) into an explicit functional form after considering independent variables as:

$$QFR = \beta 0 + \beta 1ACC + \beta 2TRANS + \beta 3VR + \beta 4COMP + \beta 5FR + e \quad (II)$$

where:

$\beta 0$ = constant term;

ACC = accounting of public institutions;

TRANS = transparency;

VR = value relevance;

COMP = comparability;

FR = full representation;

e = error term.

$\beta 0$-$\beta 5$ are the parameters to be estimated. The expectation of a priori is that $\beta 1 > 0$, $\beta 2 > 0$, $\beta 3 > 0$, $\beta 4 > 0$ and $\beta 5 > 0$.

⮕ Data analysis and result

■ Descriptive statistics

Table 1. Answers on key issues related to the implementation of IPSAS
and the quality of financial reporting in Romanian public institutions

Item no.	Variable responses (in %) by preparer of the financial statements (accountants)	Full agreement	Agreement	Neutral	Disagreement	Total disagreement
1	The implementation of IPSAS will improve the responsibility of financial reporting in the Romanian public institutions?	117	46	1	0	0
		71%	28%	1%	0	0
2	The implementation of IPSAS is necessary for the transparency of financial reporting in the Romanian public institutions?	81	81	2	0	0
		49%	49%	2%	0	0
3	The implementation of IPSAS will increase the value for the beneficiaries of the information from the financial reports in the Romanian public institutions?	73	87	4	0	0
		45%	53%	2%	0	0
4	The implementation of IPSAS will increase the comparability of financial information between Romanian public institutions?	66	92	5	1	0
		40%	56%	3%	1%	0
5	The implementation of IPSAS will improve the faithful representation of financial reporting in the Romanian public institutions?	75	80	9	0	0
		46%	49%	5%	0	0
6	The implementation of IPSAS will improve the overall quality of financial reporting in the Romanian public institutions?	93	70	1	0	0
		57%	42%	1%	0	0

Source: Questionnaire application result, 2022.

In Table 1 we have presented the questionnaire applied and the summary of the responses received. This presents the descriptive statistics of respondents on the issue of IPSAS adoption and the quality of financial reporting in the Romanian public institutions. Thus, as far as the respondents are concerned, we can find that:

✓ 99% believe that the adoption of IPSAS will improve the responsibility of financial reporting in the Romanian public institutions.

✓ 98% agreed and fully agreed that the adoption of IPSAS will increase the transparency of financial reporting in the public institutions in our country.

✓ 98% believe that the adoption of IPSAS will communicate value relevance to users of financial information in the Romanian public institutions.

✓ 96% are of the opinion that the adoption of IPSAS will increase the comparability of financial information of public institutions in our country.

✓ 95% believe that the adoption of IPSAS will improve the complete overview of financial reports from the Romanian public institutions.

✓ 99% agreed and fully agreed that the adoption of IPSAS will improve the overall quality of financial reporting in the Romanian public institutions.

From the results of the questionnaire, a high degree of awareness of the benefits of adopting IPSAS on the financial reporting system of public institutions is observed.

■ **The result of the regression analysis**

The survey results were processed in 2023 using SPSS software to build and validate predictive models, an useful tool in data analysis and visualization.

Table 2. The result of the regression analysis

$$QFR = \beta_0 + \beta_1 ACC + \beta_2 TRANS + \beta_3 VR + \beta_4 COMP + \beta_5 FR + e$$

Model summary				
Model	**R**	**R-squared**	**Adjusted R-squared**	**Standard error of estimate**
1	0.818[a]	0.768	0.650	0.51132
[a] Dependent variable: Adopting IPSAS				
[b] Predictors: Quality of financial reporting (responsibility, transparency, value relevance, comparability and complete representation)				

Source: SPSS analysis, 2023.

The results in Table 2 point that independent variables show that R^2 adjusted for the implementation of IPSAS is 65% for the total sample. This explains the importance of explanatory variables as compared to dependent variables that have a high relationship.

The study of the association between a continuous variable and several discrete variables (independent variables, factors) requires an analysis tool that can differentiate the influence of each factor, as well as the combined influence, but also the interaction between them. The ANOVA analysis was used for this purpose.

Table 3. The F-test and the significance level

ANOVA[a]

Model	Sum of squares	df	Mean square	F-test	Significance
Regression	2.169	5	0.434	1.704	0.137[b]
Residual	40.221	158	0.255		
Total	42.390	163			

Source: SPSS output from field data, 2023.

Table 3 shows that both the F-test (1.704) and the significance level (0.137) is greater than 0.05, which confirms that the result is statistically significant.

Table 4. The t-test statistic

Coefficients[a]

Model	Non-standard coefficients		Standardised coefficients	t-test statistic	Significance
	B	Standard error	Beta		
β0 (Constant)	4.578	0.660		6.938	0.000
β1 (Responsibility)	-0.090	0.089	-0.083	1.017	0.311
β2 (Transparency)	0.149	0.079	0.154	1.879	0.062
β3 (Value relevance)	-0.143	0.076	-0.152	1.887	0.061
β4 (Comparability)	0.113	0.071	0.127	1.587	0.114
β5 (Full representation)	-0.027	0.068	-0.032	1.404	0.687

Source: SPSS output from field data, 2023.

Table 4 reveals that the t-test of all explanatory variables has a statistical significance, since they are greater than the zero value, which is the a priori expectation of this research.

⊃ Conclusions

This paper examines the quality of financial reporting in Romanian public institutions following the implementation of IPSAS using the accounting departments of mayoralties in Romania as case research. This research confirms that the implementation of IPSAS will significantly improve the quality of financial reporting in Romanian public institutions by considering all the essential elements of good financial reporting.

The following **conclusions** are highlighted based on the results of the research:

(i) The implementation of IPSAS will increase the confidence of financial analysts and institutional investors who rely on the financial reports of public institutions to make investment decisions. The effect on the Romanian economy is that it will improve the level of foreign direct investment in the country due to the high confidence of investors.

(ii) The implementation of IPSAS will boost the country's transparency index from global rating agencies. It will also improve the country's image of the corruption perception index, which has remained high in one of the most corrupt countries in the world.

The following **recommendations** are highlighted on the basis of the findings of this research:

(i) This research recommends that regulators put in place appropriate measures to ensure compliance on the part of those responsible for preparing the financial reporting of public institutions. Measures should

also be taken to improve the quality of disclosure of relevant information on financial reporting, which will help users make useful economic decisions.

(ii) It is necessary for the Romanian public institutions to provide specific, in-depth training for the accounting and audit staff of public institutions on the implementation of IPSAS. An appropriate provision is also needed regarding the information system in order to facilitate the proper functioning of the implementation of IPSAS.

This study deepens the research on the implementation of IPSAS and the quality of financial reporting in Romanian public institutions. **This paper contributes to the deepening of research in this field in the following ways:**

(i) This document includes responsibility, transparency, value relevance, comparability and full representation as essential qualities of financial reporting, which serves as an indicator for measuring the quality of financial reporting with regard to the implementation of IPSAS.

(ii) The contribution from point (i) above demonstrates that decision-makers and regulatory actors should not only focus on the implementation of IPSAS, but also improve the interpretation and application of the applicable standards governing the quality of financial reporting in Romanian public institutions. This can also lead to the formulation of principles and accounting policies regarding the quality of financial reporting in the preparation of the IPSAS-based financial statements.

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