Varazdin Development and Entrepreneurship Agency and University North
in cooperation with
Faculty of Management University of Warsaw
Faculty of Law, Economics and Social Sciences Sale - Mohammed V University in Rabat
Polytechnic of Medimurje in Cakovec
Croatian Chamber of Economy

Economic and Social Development

7th ITEM Conference - "Innovation, Technology, Education and Management" and
67th International Scientific Conference on Economic and Social Development Development

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Editors:
Damira Djukec, Igor Klopotan, Luka Burilovic

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Editors:
Damira Djukec, The Polytechnic of Međimurje in Cakovec, Croatia
Igor Klopotan, The Polytechnic of Međimurje in Cakovec, Croatia
Luka Burilovic, Croatian Chamber of Economy, Croatia

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THE TRADE-OFF BETWEEN INTERNATIONAL ACCOUNTING CONVERGENCE AND IFRS IN-COUNTRY ADJUSTMENTS

Alexandra Fontes
REMIT; ESTG, Polytechnic Institute of Viana do Castelo,
Viana do Castelo, Portugal
afontes@estg.ipvc.pt

Ana Paula Silva
CEOS.PP; ESCE, Polytechnic Institute of Viana do Castelo,
Valença, Portugal
apaulasilva@esce.ipvc.pt

Humberto Ribeiro
GOVCOPP; ESTGA, University of Aveiro, Portugal
hnr@ua.pt

Sandra Raquel Alves
CEOS.PP; ESTG, Polytechnic Institute of Leiria, Portugal
raquel.alves@ipleiria.pt

ABSTRACT

The problem of reaching international accounting convergence has enticed voluminous research, and evidence suggests that adoption of International Financial Reporting Standards (IFRS) or IFRS-based accounting models, per se, may be insufficient. Institutionalists underline the possibility of decoupling. This has motivated the preparation of this longitudinal and qualitative study using Portugal as an exemplar, to assess the perceptions of tax officials towards the International Accounting Standards Board (IASB) model and, more particularly, the perceived need to adjust IFRS to different national contexts and cultural traditions. Interviews with nine tax officials were conducted at two strategic moments: in 2009, just before formal adoption of an IFRS-based model in Portugal, in force from 1 January 2010 onwards; and in 2017, one year after the IFRS model adopted had already undergone a second round of in-country adaptations. The results obtained in this study suggest high receptivity towards IFRS adjustments when applied to the Portuguese accounting system, despite some individuals surveyed acknowledged a negative impact on the convergence of national standards with IFRS. The perceived need to overcome important national constraints on the adoption of IFRS in Portugal appeared to overpower the pursuit of an ideology of de facto convergence, which is, arguably, compatible with the phenomenon of decoupling.

Keywords: *Harmonization/Convergence, International Financial Reporting Standards (IFRS), Portuguese Accounting System, Accounting Change, Perceptions*

1. INTRODUCTION

The IASB leading role in the current landscape of international accounting convergence was reinforced by the change in the European Union (EU) accounting harmonization strategy – outlined in 1995 in Communication 95(508) entitled “Accounting Harmonization: A new strategy vis-à-vis international harmonization.” This set the EU a more interventionist role in the International Accounting Standards Board’s (IASB) harmonization process. This cooperation process between the IASB and the EU culminated in the release of EU Regulation 1606/2002, requiring all EU listed companies to prepare their consolidated financial statements in accord with ‘EU-endorsed IFRS’, from 2005 onwards.

Portugal has not been divorced from the trend towards international convergence (Fontes *et al*., 2005). Following these developments, in July 2007, the *Comissão de Normalização Contabilística* (CNC - Portuguese accounting standards setter) approved a new accounting standardization model entitled "*Sistema de Normalização Contabilística*" (SNC - Accounting Standardization System) based on the IASB model adopted by the EU, in force from 1 January 2010 onwards. The SNC is an adaptation of IAS/IFRS to Portugal being compatible with IASB standards (Isidro & Pais, 2017). It should be adopted by unlisted companies. While international accounting convergence is pursued, there is literature claiming that adoption of IFRS or IFRS-based accounting models *per se* may prove insufficient to reach improved, fully harmonized, reporting (Ball, 2016; El-Helaly *et al*., 2020; Fuad *et al*., 2019; Isidro *et al.*, 2020). It has also been claimed that differences in the national environments justify and require the existence of different accounting standards (Tyrrall *et al*., 2007). The primary objective of this study is to examine tax officials' perceptions regarding the need to adjust IFRS at destination (IFRS in-country adjustment). Despite the willingness of the CNC to implement IFRS at the national level, it is commonly accepted that the IASB accounting model is of Anglo-Saxon accounting origin and, therefore, its adoption represents a substantial detachment from the traditionally Portuguese Accounting System (PAS), which is based on the Continental European tradition (Caria & Rodrigues, 2014; Guerreiro *et al*., 2012). Indeed, the development of financial reporting in Portugal has been mainly influenced by the tax system requirements, which motivated selection of tax officials to be interviewed. Both the interviewed professional group and the country on which this study is based upon, remain under-researched (Silva *et al*., 2021). The timing of this longitudinal survey is particularly relevant. The first round of interviews took place in 2009, just before formal adoption of an IFRS-based model in Portugal. A second round of interviews was conducted in 2017, one year after the IFRS model adopted in Portugal had already undergone a second round of in-country adaptations. Our core phenomenon does have echoes in prior management change and institutional literature. The gap often found between the formal and the actual organizational structure, has been named metaphorically by the institutionalists as 'decoupling' (Meyer & Rowan, 1977). Since the emergence of the thesis suggesting that the national accounting systems are a product of the environment found in different countries, a growing body of research in international accounting is related to the identification and examination of the environmental factors influencing accounting development (e.g. Albu *et al*., 2011, 2014, 2020; Gray, 1988; Nobes, 1998; Silva *et al*., 2021; Zeghal & Mhedhbi, 2006). There is a wide consensus that the following environmental factors influence the development of a country's accounting system: the legal system; sources of external finance; the influence of tax laws in financial reporting; importance of the accounting profession; and culture. This paper proceeds as follows. The next section reviews relevant literature and provides an overview of the Portuguese IFRS-based accounting system. This is followed by the research methodology. Then, there is the results section, and, finally, the conclusion ends the paper.

2. ISSUES REGARDING IFRS-BASED ACCOUNTING SYSTEMS ADOPTION

As discussed in earlier research (Silva et al., 2020), the adoption of IFRS-based accounting systems is challenging and may not be enough to achieve global accounting harmonization. Oliver (1991) posited that, when an organization foresees that conformity to institutional pressures will result in economic and legitimacy benefits, it will probably adopt the most passive resistance response (i.e., acquiescence). Accordingly, more favourable perceptions towards the adoption of the new accounting system are expected if individuals believe that its adoption will result in economic and legitimacy benefits, since under these circumstances, they are less likely to develop resistance feelings. In contrast, when organizations anticipate that conformity will result in low legitimacy and economic benefits, they will possibly adopt more active resistance strategies, such as "attempt to compromise on the requirements for conformity, avoid the conditions that make conformity necessary, defy the institutional requirements to which they are advised to conform, or manipulate the criteria or conditions of conformity" (Oliver, 1991, p.161). In turn, this may result in *"de-coupling"*: organizations say that they are complying with the imposed requirements, but they may be adopting a kind of ostensible compliance (*"window-dressing"*) (Rodrigues & Craig, 2007, p. 753). The concept of isomorphism (a key element of *institutional theory*), as described by Rodrigues and Craig (2007) in the context of accounting research to understand the developments in international accounting, can be used to reflect the intrinsic and affective benefits components of the perceived value of IFRS and the new accounting model. Indeed, this concept posits that organizations adopt certain practices in order to achieve legitimacy and social acceptability from other organizations - regardless of their actual usefulness. Based upon the perspectives of the *new* institutional theory, Rodrigues and Craig (2007) suggested that international accounting standards are chosen not just on efficiency grounds, but often to improve the reputation of an organization for being rational, modern, responsible, and legally compliant. It follows that users and preparers may also support the adoption of IFRS if they perceive that these standards are widely accepted and that they will confer legitimacy to the Portuguese accounting system and, consequently, to Portuguese companies. It is generally argued in the accounting literature that the main significant barriers to IFRS adoption are the lack of technical accounting expertise (*e.g.* Chand, 2005; Kılıç & Uyar, 2017; Sellhorn & Gornik-Tomaszewski, 2006; Zeghal & Mhedhbi, 2006) and the accounting culture (*e.g.* Rodrigues & Craig, 2007; Vellam, 2004; Zeghal & Mhedhbi, 2006). Indeed, the lack of professional expertise will require significantly more efforts by the users and preparers to adopt, to implement and understand the new accounting standards. Similarly, if users and preparers are familiar with the underlying principles of IFRS, the cultural shock will not be as big, and, therefore, its adoption will not require such a substantial effort. Hence, the users and preparers' preparedness, as well as their commitment with accounting traditions, may affect their perceptions regarding the IFRS adoption. Furthermore, the experience of many countries suggests that IFRS are too complex and costly for SMEs (Kılıç & Uyar, 2017; Rodrigues & Craig, 2007).

3. THE PORTUGUESE IFRS-BASED ACCOUNTING SYSTEM

Despite the IASB issued the IFRS for SMEs in 2009 to respond to the idiosyncrasies of the smaller, the Portuguese SNC is based upon the full set IFRS. Yet, the Portuguese IFRS-based accounting system is characterized by the existence of different levels of standardization. Larger entities must adopt 28 standards, all of which except one are tightly based upon EU-endorsed IFRS/IAS – the so-called 'general regime'. Furthermore, there is another standard tailored for small entities, which is a simplified adaptation of the different themes addressed in the general regime. In turn, micro entities may choose to adopt an even further simplified standard. For further details of the SNC accounting system see, for example, Isidro and Pais (2017). To align the SNC with the EU Directive No. 2013/34, Decree-Law No. 98/2015 of 2 June 2015 brought some amendments to SNC, in force from 1 January 2016 onwards. Changes implemented include the following: new models of financial statements; reduction in the disclosures required by standards, especially regarding micro entities which were discharged from the preparation of the Annex; extension of the mandatory adoption of the permanent inventory system to small entities; mandatory amortization of goodwill from business combinations; alteration of the thresholds that define the different categories of entities, particularly, enlargement of the thresholds of a small entity. Upon adoption of SNC in 2010, a small entity was one that did not exceed any two of the following limits: 1.5 million euros for balance sheet; 3 million euros for turnover; 50 employees.

Since 2016, the balance sheet threshold was enlarged to 4 million euros, and the turnover ceiling was increased to 8 million euros. The number of employees' limit remained unchanged. As a result, since 2016 many more entities in Portugal could report under the simplified standard for small entities.

4. RESEARCH METHODOLOGY

This is a qualitative study aimed at presenting in-depth contextually rich analysis of tax officials' perceptions regarding the need to adjust IFRS at destination, using Portugal as an exemplar. Therefore, at the outset the leading objective of this research was to generate detailed insights to the detriment of any quest to generalize the perceptions gained. The evidence reported in this paper is part of a comprehensive longitudinal research, which involved semi-structured interviews with tax officials, of an average length of around 50 minutes in 2009 and in 2017. The first round of interviews took place during the year before formal adoption of an IFRS-based model in Portugal. Follow up interviews were conducted in 2017, one year after the IFRS model adopted had already undergone a second round of in-country adaptations. To analyse how perceptions evolved according to the stage of the SNC implementation process, interviewees were the same in both years of analysis. Theoretical saturation (Strauss & Corbin, 1998) delivered a final sample size of nine in each of the years of analysis. For anonymity, tax officials (TO) are identified by the order of their interviewing, followed by the year of the interview. Hence, for example, TO1_2009 stands for tax official number 1, as interviewed in 2009. Sampling of interviewees was non-probability as it was intended to interview knowledgeable and experienced tax officials to foster extraction of rich data. As a result, they all held a bachelor's degree or above, and in 2017 all but one had more than 15 years of inspecting experience. In 2017, the dominant age group was 35-44 years (n=6), and all but one were male.

5. DISCUSSION OF RESULTS

Respondents were asked to indicate whether they agreed with the need to adjust IFRS when applied to the PAS. Responses are summarised below in Table 1.

	Agreement		**Disagreement**		**Undefined**		**Total**
	Frequency	**%**	**Frequency**	**%**	**Frequency**	**%**	
Prior to adoption	5	56	2	22	2	22	9
After adoption	8	89	1	11	0	0	9

Table 1: Perceived need to adjust IFRS at destination

Overall, tax officials supported the need to adjust IFRS at destination to account for national environmental specificities. Evidence gathered should be interpreted considering that interviews after adoption took place in 2017, when the IFRS model adopted in Portugal had already undergone a second round of in-country adaptations in the year before. So, we may infer that the experience with in-country adjustments influenced positively the perception of their adequacy (n=5_2009; n=8_2017). The single tax official who did not agree with IFRS adjustments in 2017 invoked their negative impact on international comparability and reasoned that adjustments made were the outcome of the misfit of SNC with the national context:

"*If the idea was to achieve the highest degree of comparability, then we should keep what's out there, period! And put it to work in here! If people don't adapt, then it's because the new standards don't really make sense.*" (TO4_2017)

In the same manner, two other respondents, despite being generally favourable to IFRS in-country adaptations upon initial adoption, shared the view that additional simplifications introduced as of 2016 represented a retrocession in the harmonization. They regarded initial resistance and early obstacles to be time bridgeable:

"*…it was a matter of time; people should be told to come to their senses and move forward.*" (TO2_2017)

"*It remains to be seen if the POC* [the previous Portuguese accounting system] *would be better than the overly simplified SNC!*" (TO6_2017)

Notwithstanding, early pleas for IFRS adjustments before SNC adoption, were vividly emphasised in 2017:

"I do not agree with minor adjustments, but rather with substantial changes." (TO 7_2009)

"*There is insufficient simplification of the financial instruments standard.*" (TO2_2017)

"In many instances, an automatic translation of concepts was made, while they should be adjusted to our reality, which was not considered. For example, the term "perdas por imparidade" [impairment losses] *here in Portugal does not make much sense; if you ask experts the origin of the term, they can't associate it with Portuguese." (TO3_2017)*

Translation issues had already been invoked as problematic modifications prior to adoption:

"*The translations of international standards to Portuguese are made with terms that you read and realize that they do not convey the intended idea, the spirit of the standards.*" (TO1_2009)

"*I have some concerns in terms of terminology... we know of the difficulties that the Portuguese face when translating Anglo-Saxon expressions. And so, sometimes we take the risk if we are not careful and accurate enough in this translation attempts ...it creates some noise, some disturbance in the interpretation of words. This causes me some worries - that the users, the agents involved, cannot make appropriate interpretations of the expressions. Therefore, I clearly share the view of some people who point out paths towards the perfection of language to be employed, in an attempt to use the Portuguese words which may better reflect the reality that you want to convey…. But, I think that these disputes are salutary, as they lead us to think that one needs a rigorous terminology for consistent interpretation of the same reality…. it makes sense to worry ourselves with all of this* [the terminological aspects]. *And I do not know to what extent this has been given thorough reflection."* (TO5_2009)

This evidence is supported by some authors' concerns (e.g., Nobes, 2006; Zeff, 2007) that the accuracy of IFRS national translations may impair global convergence and comparability. In this regard, Nobes (2006, p. 237) noted that: "Under the EU Regulation 1606, the various translations of IFRS into European languages have legal status in their various countries. As in any field, there is a risk that the process of translation will change or lose meaning from the original version, in this case English". On the other hand, these observations contrast with Tyrrall *et al*.'s (2007) findings, whose respondents pointed out the lack of national language translations of IFRS as one of the problems of IFRS implementation in Kazakhstan. Similarly, the study of Abd-Elsalam & Weetman (2003) showed that the lack of official national translations increases the likelihood of non-compliance with unfamiliar IFRS requirements.

Likewise, Alp & Ustundag (2009) reported that one of the key challenges in the adoption and implementation of IFRS in Turkey included the IFRS translation issue. The chart of accounts was an in-country adaptation present in all interviewees' spontaneous rhetoric in 2009 and addressed impromptu by only three tax officials in 2017. Furthermore, while in 2009 most of the tax officials disagreed with the maintenance of the chart of accounts, this adaptation was welcomed by the few tax officials who still recalled it in 2017. Early interview evidence gathered in 2009 brought into light several drawbacks attached to the maintenance of the chart of accounts. It was said that it may favour decoupling; (ii) it may limit the spirit of the international accounting standards; (iii) it may hinder the occurrence of a cultural change; and (iv) it may restrict the development of the accounting profession. On the other hand, the tax officials who welcomed the preservation of the chart of accounts in 2017 reasoned it assured less disruption with the previous accounting system and culture (TO2, TO3), and it allowed a better fit with the objectives of financial statements in Portugal (TO8). The following are illustrative statements:

"*Since we've always been used to coding, i.e. we've always used the code and the account designation, I think it* [the maintenance of the chart of accounts] *was very well done*." (TO3_2017)

"*It* [the maintenance of the chart of accounts] *seems to me a good decision considering the stakeholders in our country, that is, those who are the main recipients of financial information. Whether we like it or not, for the great majority of our companies, say 90 to 95% of our companies, the main recipients of financial information are the banks, which are the main financers, and then the tax authorities. Therefore, these are entities that need codes of accounts in order to be able to treat the information in a standardized manner. And this is an example of an adaptation to the realities proper to our country, that is, the financing of our companies that make great use of banking, and the issue of taxation that is very important whether we like it or not*." (TO8_2017)

Importantly, arguments put forth by interviewees after adoption to support the chart of accounts as above described, provide support to that its preservation may hinder the occurrence of a true cultural change to implement the true spirit of the international accounting standards, as anticipated by tax officials in 2009. Consistent with this view, arguably, the fact that in 2017 only three tax officials recalled spontaneously the preservation of the chart of accounts reflects a well ingrained, taken for granted, adaptation. One of the adjustments interviewees liked the most prior to IFRS adoption was the existence of different levels of standardisation within SNC. Consistently, on being asked to speak freely about the recent changes as of 2016, the enlarged thresholds for small entities was the most often spontaneously cited 2016 change (TO4; TO5; TO7; TO9; 44%). Such tax officials welcomed the possibility of many more firms being able to abide by the standard for small entities rather than the full set of standards in that it represented an important burden-relief for the resource-constrained smaller firms. Some other amendments made to SNC that became effective in 2016 were spontaneously recounted: (i) small entities (as redefined in 2016) ceased to be exempt from the permanent inventory system (TO8, TO3), and (ii) micro entities were discharged from preparing the Annex (TO4, TO3). The former aspect was seen by both tax officials who cited it as an absolutely disproportionate requirement given the dimension of the companies involved. One of the tax officials even argued it is a misfit with the cost-benefit balance endorsed by the Conceptual Framework.

This is illustrated by the following quotations:

"*I think the limits are far too low for the mandatory permanent inventory: it is unthinkable, today, that a company that exceeds those two limits of the three (700.000 euros for turnover, 350.000 euros for balance sheet, and 10 employees) is required to keep a permanent inventory: if we think, a company that sells 700.000 euros will reach 350.000 euros of balance sheet very quickly just on the basis of its inventories and receivables; if the company is a services provider, then it will also easily fall outside the thresholds of a micro entity, not because of the balance sheet but rather on account of the number of its employees. So, we are talking about very small companies, with no business structure at all! I know several of them making 700.000 euros, where there are only two persons there! They struggle to issue invoices in a computerized system, let alone running a permanent inventory!.. That is, in the issue of inventories, I think this is a total aberration!*" (TO3_2017)

"*If we take into account the universe of companies that are covered by the permanent inventory system, it is completely disproportionate, it makes no sense; the big problem, in my opinion, of the Accounting Standardisation System and these recent amendments, is the question of the relationship, which is written in the Conceptual Framework - the balance cost-benefit: there is still a lot of cost for little benefit in my opinion*." (TO8_2017)

Reflecting a quest for IFRS detailed implementation guidance, the SNC also received criticism for not setting any guidelines as to the appropriate periodicity for reporting the cost of goods sold and inventories:

"*Under the permanent inventory system, supposedly at any time you must know the cost of goods sold or materials consumed; well, it is not clear how often it is "any time", how often, for example, you must conduct inventory counts in the warehouse; it is so unclear that, recently, the Tax Administration itself had to rule on this, and it defined a monthly periodicity. Now what do we have? The Tax Administration to define the periodicity with which the permanent inventory is to be made because the CNC says nothing about it*." (TO8_2017)

The two tax officials who recalled the Annex exemption for micro entities were divided in their views: one tax official welcomed this change by arguing micro entities' businessmen see their information needs amply fulfilled from the balance sheet and income statement alone; another tax official viewed this change as mere window-dressing, not representative of a true burden relief in that the Annex had never been true disclosure, consistent with the claimed relative unimportance of financial reporting to management:

"But this [the Annex discharge for micro entities] *does not represent any reduction of effort for companies because it is a mirage, it is a mirage, it is a falsehood someone, beginning with the certified accountants, who are the executors of this, saying that they have ever prepared the Annex decently so to speak … There was a formal requirement of disclosure … but then in practice no one did it! …. So, in practice, having taken away the Annex is inconsequential, truly, because in practice I already had no such company information!*" (TO4_2017)

Finally, the SNC's internalization of the standard for micro entities (TO4) and the compulsory amortization of goodwill from business combinations (TO3) were also spontaneously recalled as recent in-country adaptations, in both cases welcomed.

6. CONCLUSION

As far distant as seven years after formal adoption of SNC, an IFRS-based model in Portugal – a country formerly classified as Continental European – our findings are compatible with the concepts of resistance to change and decoupling. Particularly, evidence gathered suggests tax officials' commitment towards the accounting reform to have been hampered by country-specific factors (institutional contradictions), including, but not limited to, the Continental European accounting cultural background. Such inference, reiterating the role of the existing national culture, clearly conforms to the institutional theory emphasis on the embedded rules and values in a social system as a source of resistance to change. Consistently, IFRS in-country adjustments were mostly welcomed, both just before SNC adoption in 2009, and most evidently, seven years after adoption, in 2017, when a second round of in-country adaptations had already been implemented in 2016. Despite adjustments made, interviewees still perceived instances of what they considered to be IFRS insufficient adaptation to Portugal as there were pleas for further amendments. These amendments were regarded as a strategy to manage IFRS in-country adequacy. Thus, our evidence signs some calls and proposals to adjust the IASB standards to the needs and limitations of the national reality. However, such response is close to one of the manipulation tactics pointed by Oliver (1991) – the influence tactic – as it might mirror an attempt to shape institutional processes, and thereby signal partial conformity to institutional rules (Campbell, 2004; Scott, 2010). Undertaking in-country adjustments as a strategy to overcome institutional contradictions might generate adverse consequences for the adoption and implementation of IFRS or IFRS-based accounting systems, such as: (i) the decoupling - namely, the maintenance of the caution and secrecy approach, and the linkage between taxation and accounting; (ii) the manipulation risk; and (iii) poor adjustment to change. This study remains exploratory in nature. An avenue for future research could be to compare the experience of different countries with IFRS adoption to investigate whether institutionalization outcomes are any different depending on the extent and types of IFRS in-country adaptations. Insights thereof would be of utmost importance to inform national standard setters.

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