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The preparedness of companies to adopt International Financial Reporting Standards: Portuguese evidence

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Abstract

This paper uses ordinal regression, structural equation modelling, and multivariate analysis techniques to investigate the preparedness to adopt IFRS that was exhibited by listed Portuguese companies in August 2003. We find the level of preparedness was significantly associated with company size, commercial internationalization, audit by a 'Big 4' accounting firm, and profitability. Our findings will help to indicate the pre-conditions that are likely to spur lagging companies (and countries) to prepare to implement IFRS.

Keywords: International Financial Reporting Standards; Harmonization; Compliance; Adoption; Portugal

1. Introduction

Many companies throughout the world have not adopted, or have not been required to adopt, International Financial Reporting Standards (IFRS). On 4 January 2007[1] there were about 31 countries, e.g. Argentina, Bangladesh, Bhutan, Ivory Coast, Fiji, Ghana, Mali, Moldova, Niger, Syria, Thailand, Togo, Tunisia, and United States of America where *direct use* of IFRS is not permitted by domestic listed companies (Deloitte, 2007). In some cases this is explained by countries electing to retain local Generally Accepted Accounting Principles which are said to be based on, or similar to, or converged with, IFRS. In 21 of the 28 European Union and European Economic Area countries, e.g. Portugal, Spain, and France, it is mandatory for *listed* companies to use IFRS, but *unlisted* companies have the option to use or not to use IFRS (Deloitte, 2005, p. 14).

The situation in some other countries is not clear. The International Accounting Standards Board (IASB), on 4 January 2007, was seeking information about whether IFRS had been mandated or permitted for use in 52 other countries, e.g. Afghanistan, Algeria, Belarus, Cuba, Ethiopia, Iran, Iraq, Liberia, Paraguay, Rwanda, Zaire (Deloitte, 2007). Although there has been widespread *voluntary* adoption of IFRS by multinational corporations (MNCs), a feature of international accounting practice over the past decade has been that the level of preparedness to adopt IFRS has varied widely between companies and countries.

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[1] This is the date of the last updating of this information on the Deloitte (2007) website, last accessed on 9 February 2007.

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The forces compelling international integration and globalization in all realms of human endeavour are intensifying (Volcker, 2000, p. 210) and many smaller countries are finding these forces hard to combat. In the discipline of accounting, globalisation poses many challenges, as Gallhofer and Haslam (2006) have noted. Support for a regime of global accounting standards is advocated commonly because such standards are consistent with the broad thrust of globalization initiatives endorsed by politically influential bodies such as the World Trade Organization (WTO), Organization for Economic Co-operation and Development (OECD), International Monetary Fund (IMF) and the World Bank (Graham & Neu, 2003; Volcker, 2000). However, some dissonant voices express the view that accounting harmonization processes repress important differences and idiosyncracies in national systems of accounting (Gallhofer and Haslam, 2006, p. 917). It seems sensible to acknowledge that financial reports, drawn up in accord with IFRS issued by the IASB, are a power discourse—especially so when the large accounting firms, the EU and other coordinating agencies (World Bank and OECD) are disposed to accept, as taken-for-granted, that accounting will be better if IFRS are adopted (Hopwood, 1994; Neu, Gomez, Léon, & Zepeda, 2002; Rodrigues & Craig, 2007).

The major aim of this paper is to determine the characteristics of the listed companies in Portugal that were better prepared than others to adopt IFRS. We use the term 'prepared' in its sense of readiness. Thus, 'preparedness' is evidenced by such factors as training of staff, and accommodative changes to accounting and financial reporting systems. We do not regard 'preparedness' merely to be a fuzzy expression indicating latent intent or inclination to adopt IFRS. Our findings should assist domestic and international standard setting agencies, regulatory authorities, and the accounting profession, to understand the company characteristics that have been associated with the adoption of IFRS, especially in small countries. One significant characteristic that will be of interest to many readers of this journal, is the strong influence of a company having a Big 4 accounting firm as its auditor.

2. Literature review

Compliance studies have determined the characteristics of companies which have adopted international accounting standards voluntarily (García & Zorio, 2002; Murphy, 1999; and the other studies cited in Table 1). Our study has a similar purpose: it seeks to understand the characteristics of companies which explain their level of preparedness to adopt IFRS. We acknowledge that some companies are likely to be reluctant to use new sets of accounting standards, and that applying a single set of standards to all reporting entities, irrespective of size or internationalization, might be inappropriate (Rodrigues & Craig, 2007). Nonetheless, knowing the characteristics of the companies which are prepared to adopt IFRS will assist standard setters, regulators, governments and accounting scholars to better understand the factors that affect the diffusion of IFRS; and, as well, it will help them to understand how accounting can be used to shape, normalize and instrumentalize the conduct, thought, decisions and aspirations of companies (Neu, 2001, quoting Miller & Rose, 1990).

Many studies of the voluntary adoption of IFRS or International Accounting Standards (IAS) (see recent examples in Table 1), use univariate and multivariate analysis techniques in which voluntary adoption of IFRS is defined as a dummy dependent variable (1 = adopt IFRS; 0 = not adopt IFRS).[2] The characteristics of companies adopting IFRS are the independent variables. We reviewed the range of characteristics included in these studies and selected three independent variables that had been significant in more than one such study: size (SIZE), commercial internationalization (COMINT), and auditor type (AUD). Although financial internationalization was also a significant characteristic in four of the studies summarised in Table 1, we did not include this variable because 93.5% of the companies in our sample are listed only in Portugal. However, we also included two additional independent variables: rate of profitability (ROE), and leverage (DEBT). Although these characteristics were significant in only one of the studies cited in Table 1, they were thought important enough to be included as independent variables in several of the studies. We were prompted also to add a sixth variable, level of investment in foreign company equity (INVFR). We did so on the grounds of competitive isomorphism: that is, whenever there is one best, cheapest or most efficient way to do something, then competitive forces will impose that best way upon organizations (Carruthers, 1995, p. 317; DiMaggio & Powell, 1983). In this specific case, multinational corporations achieve cost savings if foreign subsidiaries use IFRS since consolidating group accounts will become cheaper and easier.

[2] We use IFRS as a default acronym to also include, where appropriate, IAS.