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Factors influencing the preparedness of large unlisted companies to implement adapted International Financial Reporting Standards in Portugal

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ABSTRACT

The *Sistema de Normalização Contabilística* [SNC] is the Portuguese title for the corpus of International Financial Reporting Standards [IFRS] that have been adapted for use in Portugal by unlisted companies. Based on an analytical framework that draws on aspects of new institutional theory, we surveyed 116 large unlisted Portuguese companies in September 2009 to identify factors associated with their preparedness to implement the SNC. Generally, their degree of preparedness was low. Institutional factors that influenced the degree of preparedness positively included the participation of a parent company in conversion procedure decisions, the presence of exclusively Portuguese shareholders, the conduct of export activities, and mimetic behaviors. The results reveal that important insights can be obtained from complementing a study of isomorphic influences with the concepts of resistance and institutional logic. Though coercive and mimetic institutional factors influenced levels of preparedness positively, the preparedness process was undermined by resistance within the Portuguese accounting profession and by the embeddedness of code-law practices in the prevailing logic.

1. Introduction

From 2005 onwards, compliance with International Financial Reporting Standards [IFRS] became compulsory for listed companies in many countries (including those in the European Union), consistent with the “inexorable and irreversible rise of IFRS as the global accounting benchmark” (Chua & Taylor, 2008: 463). Adoption of IFRS has major implications for firms. The conversion from *national* accounting standards to *international* accounting standards is complex and time consuming. Differences between national accounting standards and IFRS need to be identified and reporting processes adapted (Ernst & Young, 2006). Additionally, cultural influences and reporting traditions have the potential to confound the process of conversion.

Large economies such as China, India, and United States [US] are engaged in projects intended to lead to convergence with IFRS. In the particular case of the US, since 2007 the Securities and Exchange Commission [SEC] has accepted foreign private issuers’ financial statements that are prepared in accordance with IFRS without requiring reconciliation to US Generally Accepted Accounting Principles [GAAP]. The SEC is also currently discussing the possibility of a “Condorsement” approach to IFRS. This option combines an endorsement mechanism of IFRS with a transition process in which US GAAP would fully

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converge to IFRS over a defined period of time (e.g., five to seven years) (SEC, 2011). Additionally, in May 2008, the Governing Council of the American Institute of Certified Public Accountants [AICPA] voted to recognize the International Accounting Standards Board [IASB] as an accounting body for purposes of establishing international financial accounting and reporting principles. Appendix A of AICPA Rules 202 and 203 was amended to give AICPA members the option to use IFRS as an alternative to US GAAP. Thus, a key professional barrier to using IFRS (including IFRS for small and medium sized entities [SMEs]) has been removed.[1] Consequently, the degree of preparedness of investors, companies, and other constituents, implicated in the incorporation of IFRS into US financial reporting systems, has become an important matter in the US. This matter is mentioned in several documents issued by the SEC as something that should be assessed when evaluating alternative approaches to adopting IFRS in the US (e.g., SEC, 2010a, 2010b, 2011).

Several studies have discussed problems of implementing IFRS (e.g., Alp & Ustundag, 2009; Ding & Su, 2008; Jaruga, Fijalkowska, Jaruga-Baranowska, & Frendzel, 2007; Jermakowicz & Gornik-Tomaszewski, 2006; Peng & van der Laan Smith, 2010). However, with the exception of the study of *listed* companies in Portugal by Guerreiro, Rodrigues, and Craig (2008), no published research has systematically evaluated the degree of preparedness of companies to adopt IFRS. This has motivated us to extend Guerreiro et al.'s (2008) study by exploring the extent to which large *unlisted* Portuguese companies were prepared, in September 2009, to adopt the new Portuguese accounting system, *Sistema de Normalização Contabilística* (SNC – Accounting Standardization System). This new system is based on IFRS and was implemented from January 1, 2010. In analyzing the preparedness of Portuguese companies to adopt the SNC, we combine the initial framework of DiMaggio and Powell (1983) with more recent perspectives of institutional theory that accommodate change, strategic choice, organizational resistance, and institutional logics (Broadbent, Jacobs, & Laughlin, 2001; Lounsbury, 2007; Marquis & Lounsbury, 2007; Oliver, 1991; Thornton & Ocasio, 2008).

This study improves understanding of the institutional elements associated with successful preparedness to adopt adapted IFRS. The explanatory variables are classified as coercive, normative, and mimetic processes (DiMaggio & Powell, 1983). To assess the degree of preparedness of Portuguese unlisted companies to adopt the SNC, a proxy was developed to capture the conversion practices used.

The institutional framework adopted is concerned primarily with how companies relate to the institutional environment, and how the effects of social expectations on companies affect company characteristics (DiMaggio & Powell, 1991). Several studies have revealed that organizations are very cognizant of the societal context and institutional rules and requirements to which they must conform in order to receive support and legitimacy from the environment (Granlund & Lukka, 1998; Mezias, 1990; Palmer, Jennings, & Zhou, 1993; Touron, 2005). Portuguese unlisted companies are no different: they are aware of the pressures they face from institutional constituents. These pressures have to be weighed by them when they are preparing to adapt their accounting practices (Hyvönen, Järvinen, Pellinen, & Rahko, 2009).

Hitherto, research on accounting harmonization has focused largely on the *pre-adoption* phase of IFRS (e.g., advantages, disadvantages, and obstacles to convergence); and on the *post-adoption* phase of IFRS (e.g., measurement of accounting harmonization and adoption effects). Research has failed to address the "middle-moment" in which companies establish mechanisms for translating new organizational procedures: that is, for interpreting and reformulating accounting practices. When new structures are being formed or changed, the effects of differentiated institutional logics (that set the grounds for action by individuals and organizations) become more evident. Accordingly, the preparedness of companies to adopt IFRS (or adapted IFRS) provides an ideal context to understand organizational behavior, the institutional logics at work, and the link between organizational forms and institutional expectations.

Additionally, by applying institutional theory to unlisted companies and by moving beyond economic explanations, we broaden the scope of previous studies of the adoption of international accounting standards and improve understanding of the behavior of unlisted companies.

We seek to understand whether (near the time for mandatory adoption of adapted IFRS for use in Portugal) *unlisted* companies had a different level of preparedness than when *listed* companies adopted IFRS in consolidated accounts in 2005 (Guerreiro et al., 2008). Thus, we respond to questions posed by Meek and Thomas (2004: 31): "What about unlisted companies and companies' nonconsolidated (i.e., individual company) accounts, particularly those from European code law countries? Will they continue to reflect national accounting systems, or will they shift away from them?" Our study complements recent explorations of the convergence practices of *listed* companies in non-common-law countries (Latridis & Rouvolis, 2010; Navarro-García & Bastida, 2010) by extending understanding of the adoption of adapted IFRS to *unlisted* companies within non-common-law countries.

Often, even within the same country, listed and unlisted companies exhibit different accounting practices. This can be attributed to the fact that the market for their financial reporting differs substantially. Even though private firms do not face the agency problems of listed companies, they do face an information asymmetry problem that affects their ability to engage in contracting with external parties (Francis, Khurana, Martin, & Pereira, 2008). As a consequence, they use IFRS to improve the quality of their financial reports. Thus, it is important to understand how unlisted companies embrace new accounting systems, based on IFRS, because such systems are being adopted worldwide.

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[1] See http://www.ifrs.com/overview/IFRS_SMES/IFRS_SMES_FAQ.html#q7 (accessed on 10 July 2011).