FEP WORKING PAPERS
Research
Progress
n. 285, August 2008

The transition to IFRS: disclosures by Portuguese listed companies

Patricia Teixeira Lopes
Rui Couto Viana

U.PORTO
FEP FACULDADE DE ECONOMIA
UNIVERSIDADE DO PORTO

THE TRANSITION TO IFRS: DISCLOSURES BY PORTUGUESE LISTED COMPANIES

Patricia Teixeira Lopes*
Faculty of Economics, University of Porto and EDGE – Research Center on Management

Rui Couto Viana
Faculty of Economics, University of Porto and EDGE – Research Center on Management

July 2008

Please do not quote without the authors' permission

*Corresponding author: Rua Dr. Roberto Frias, 4200-464 Porto, Portugal; Phone: 351 22 5571100;
Fax: 351 22 5505050; e-mail: patricia@fep.up.pt

Comments and suggestions from participants at the 2007 European Accounting Association (EAA) Conference and at the XVI Spanish-Portuguese Meeting of Scientific Management are gratefully acknowledged.

Abstract

In the context of the CESR and of the Portuguese market regulator recommendations regarding the disclosure of the impacts of the transition to IFRS, this paper analyses the content of those disclosures by Portuguese listed companies. We found a high degree of variability among the disclosure either regarding the qualitative (narrative explanations of transition) or quantitative (reconciliations) disclosures. The results show that the objective of comparability, relevance and understandability stated in CESR's recommendation were not achieved. Regarding accounting changes, the analysis shows that the reported impacts by companies confirmed expectations based on prior *de jure* studies on major impacts of changing from Portuguese GAAP to IFRS; these major impacts regard the recognition of intangibles, the accounting treatment of goodwill and financial instruments. Finally, Gray's (1980) "conservatism" index was computed using the reconciliated profits to IFRS reported by companies. This analysis shows that Portuguese standards are more conservative than IFRS. This study is relevant to several parties: to the market regulators and policy makers in predicting the level of compliance with IFRS and calling attention for the importance of enforcement mechanisms; to the preparers, auditors and users in identifying the most problematic areas of implementation of IFRS.

JEL Code: M41 Accounting

Key Words: International Accounting, Disclosure, IAS/IFRS, Portugal

1. INTRODUCTION

The transition to IFRS in 2005 by European listed companies led the Committee of European Securities Regulators (CESR) to issue the Recommendation for Additional Guidance Regarding the Transition to IFRS (CESR (2003)) with the aim to contribute to the disclosure of comparable, relevant and understandable information by companies during the transition process. This document identifies possible milestones in the transition process. One of these is the 2005 interim financial statements. In the context of this milestone, the Portuguese markets regulator (CMVM – Comissão do Mercado de Valores Mobiliários) issued a document (Statement of 15th April, 2005 regarding the obligations of issuing and disclosing quarterly financial statements: a sum up of the applicable rules in 2005, CMVM (2005)) stating that the communication regarding the impact of the transition to IFRS should be disclosed till the publication of the first quarter 2005 financial statements. Besides, CMVM considered that the disclosure of this information should be configured as a Material Event to the market.

In the context of this Statement from CMVM, we analyse the content of the communications to the market regarding the transition to IFRS made by Portuguese listed companies in the first quarter of 2005 in order to attain several research objectives. A first objective is to analyse the degree of compliance with CMVM requirements and recommendations. Secondly, we want to analyse if the information disclosed attains the objectives of comparability, relevance and understandability stated in the CESR's Recommendation. Third, this analysis allows us to identify the most problematic areas in the transition to IFRS. We compare the reported transition impacts with the expected impacts based on previous *de jure* analysis. Finally, we try to compare the degree of conservatism of Portuguese GAAP and IFRS, based on Gray's (1980) index.

This study has relevance to several parties in the national and in the international setting: to the market regulators and policy makers in identifying cases of compliance/non-compliance with the requirements of disclosure of information about the transition process and predicting the level of compliance with IFRS and calling attention for the importance of enforcement mechanisms; to the preparers of information, auditors and users in identifying the most problematic areas of adoption of IFRS, which may require particular attention. Still, describing the process of transition and implementation of IFRS by listed companies, this paper brings important contributes to regulators in their decision of extending the mandatory adoption of IAS/IFRS to non-listed companies and to individual accounts. Additionally, this research provides a broad view over the process of transition to IFRS by all Portuguese listed companies, providing a starting point for comparative studies either in a temporal basis or with other countries.

This paper is organised as follows. Next section describes legal background for the research. Section 3 provides a review of previous academic literature relevant to the research. Section 4 comprises the research design, including the detailed research questions, the description of the methodology and data. Then, results are presented in Section 5. Section 6 discusses results and concludes the paper.

2. Regulatory background

The transition to IFRS in 2005 by European listed companies led the Committee of European Securities Regulators (CESR) to issue the Recommendation for Additional Guidance Regarding the Transition to IFRS (CESR (2003)) with the aim to contribute to the disclosure of comparable, relevant and understandable information by companies during the transition process. This document identifies four different milestones in the transition process which are the publication of the 2003 annual financial statements, 2004 annual financial statements, 2005 interim financial statements and 2005 annual financial statements. According to CESR, these four milestones provide a gradual, but continued communication of the transition. Additionally, CESR recommends that the information on transition should be made easily available to all investors at the same time. For each milestone, CESR's document presents the information that should be disclosed to the market in order to attain the objectives pursued by the recommendation. Within the publication of 2003 financial statements, companies should describe their plans and degree of achievement in the transition process, covering issues such as actions and operational policies taken and risks and uncertainties associated with the process as well as the major differences already identified between present practices and IAS/IFRS policies. The information on this stage can be narrative only. Yet, within 2004 financial statements companies should disclose quantitative information on the impacts of the transition to IFRS, namely, the company should publish a reconciliation of shareholders' equity at the date of transition (for most companies it is the 1st January 2004), a reconciliation of shareholders' equity at the end of the reporting periods (31st December 2004) and a reconciliation of the profit and loss account for the year 2004. CESR makes another recommendation: this quantitative information must be released before the publication of 2005 interim information as a way of having a clear starting point. It is additionally recommended that 2005 interim financial statements be prepared under IFRS.

In the context of these milestones, the Portuguese markets regulator (CMVM – Comissão do Mercado de Valores Mobiliários) issued a document (Statement of 15th April, 2005 regarding the obligations of issuing and disclosing quarterly financial statements: a sum up of the applicable rules in 2005, CMVM (2005)) stating that the communication regarding the impact of the transition to IFRS should be disclosed till the publication of the first quarter 2005 financial statements. In line with CESR, CMVM considers that quarterly financial information that had not been preceded or accompanied by the disclosure of the impacts of IFRS would be incomplete and unclear. Besides, CMVM considered that the disclosure of this information should be configured as a Material Event to the market.

3. PREVIOUS STUDIES

Literature on implementation of IFRS in Europe, though still quite limited (Aisbitt and Walton (2005), Aisbitt (2006)), is a growing stream of literature as a consequence of the new research opportunities created by Regulation 1606/2002 (Giner and Rees (2005)).

This literature review focuses on studies that analyse the process of transition and implementation of IFRS, including those that analyse the preparation for transition and those that analyse the impact on firms' financial statements.

Based on surveys and interviews to companies, Jermakowicz (2004) studies the implementation of IFRS in Belgium, Sucher and Jindrichovska (2004) in Czech Republic and Vellam (2004) in Polland. Abd-Elsalam and Weetman (2003) study the implementation of IAS in Egypt highlighting problems related to language and familiarity with the subjects. Weibenberger *et al.*

(2004) analyse motivations that lead managers to change to IFRS in Germany and identify to what degree the objectives are attained after adoption. Jones and Luther (2005) examine the possible impact of the IFRS adoption on management accounting practices based on perceptions and expectations of managers in German companies.

Recently a number of studies attempting to analyse the impact of the transition based on the 2004 financial statements (produced under national GAAP and IFRS) is appearing. Aisbitt (2006) analyses the reconciliations of equity presented by the largest UK companies. She concludes that the overall effect on equity is not significant, but the changes in individual items can have important consequences for financial analysis and contractual obligations. Callao *et al.* (2007) and Perramon and Amat (2006) study the impact in Spanish firms. The former study analyses IBEX-35 companies and focuses on the effects of the new standards on comparability and the relevance of financial reporting in Spain. It measures the quantitative impact of the application of IFRS on financial figures and ratios. The results of the study indicate that the image of listed Spanish firms differs significantly when IFRS rather Spanish GAAP are applied in the preparation of financial information for the first half of 2004. In the balance sheet, this effect is most significant in debtors, cash and cash equivalents, equity, long-term and total liabilities. The figures are all relevant for the evaluation of a firm's financial structure. The other study analyzes the first results of IFRS implementation for the income statement for a sample of Spanish non-financial listed companies. The results confirm that the introduction of international accounting standards influence the profit results. In Portugal, Silva and Couto (2007) study companies listed in Euronext Lisbon and conclude that the Balance Sheet and Income Statement structures suffer relevant accounting conversions conditioning measures of the performance and of the financial position of firms. In Greece, Bellas *et al.* (2007) conclude that tangible assets, fixed assets and total liabilities register higher values under the new accounting standards. Jaruga *et al.* (2007) analyse the effect on income and equity in Polish companies. Their results show significant effects of IFRS implementation.

Some studies apply the Gray's comparability index in comparing national GAAPs with IFRS financial statements. Bertoni and De Rosa (2006) apply the conservatism index to Italian companies (Milan Stock Exchange), measuring the differences in net income, equity, ROE and partial items. Their findings support the hypothesis that Italian GAAP are more conservative than IFRS, but the results are not as significant as expected. Tsalavoutas and Evans (2007) analyse Greek companies examining the impact caused on companies' financial position, performance and key ratios. The findings suggest that there is a significant impact on the equity and on gearing and liquidity ratios. However, the results relating to the impact on net profit and on ROE are inconclusive.

Table 1 sums up the studies reviewed above.

Table 1: Summary of prior literature on transition/implementation of IAS/IFRS

Studies on the process of implementation (problems, perceived benefits, degree of preparedness)	Jermakowicz (2004)	Belgium
	Sucher and Jindrichovska (2004)	Czech Republic
	Vellam (2004)	Poland
	Abd-Elsalam and Weetman (2003)	Egypt
	Weibenberger *et al.* (2004)	Germany
	Jones and Luther (2005)	
Studies on the impact on financial statements	Aisbitt (2006)	United Kingdom
	Callao *et al.* (2007) and Perramon and Amat (2006)	Spain
	Silva and Couto (2007)	Portugal
	Bellas *et al.* (2007)	Greece
	Tsalavoutas and Evans (2007)	
	Bertoni and De Rosa (2006)	Italy
	Jaruga *et al.* (2007)	Poland

4. RESEARCH DESIGN

4.1. Research questions

Our research objective is to provide a broad picture of the transition to IAS/IFRS in Portugal. Having as a background the CESR's recommendation and the CMVM Statement, this paper addresses the following research questions:

- Did companies comply with CMVM statement regarding the communication to the market of the transition to IFRS effects?
- Did the information disclosed attain the objectives of comparability, relevance and understandability comprised in the CESR's Recommendation?
- Which issues involve more changes regarding recognition, measurement and disclosure policies?
- Are the reported Portuguese transition impacts expected according to previous formal comparisons of Portuguese GAAP with IFRS?
- Which are the impacts in reported equity and earnings? Are the differences material?
- Are Portuguese standards more "conservative" than IFRS?

4.2. Methodology

This analysis is directed to companies of the Eurolist by Euronext, listed in the Portuguese stock exchange (Euronext Lisbon) [1].

We analyse the communications to the market regarding the transition to IFRS made by companies through the CMVM's *Information Disclosure System*. The period of analysis is comprised between 1st January and 30th September 2005. We consider for analysis either isolated communications of the transition impacts or communications included in the 2005 first quarter financial reporting.

---

[1] Regulated Market of Official Trading, managed by Euronext Lisbon – Sociedade Gestora de Mercados Regulamentados, S.A.

In order to collect those communications, we begin by searching within the CMVM's *Material Events* database. Having detected some missing companies (non-complying with the requirement of disclosing as a Material Event), we then look for in the *Financial Information* (quarterly financial reporting) database.

4.3. Data

The total number of companies of the Eurolist by Euronext, listed in the Portuguese stock exchange (Euronext Lisbon) in 31st December 2004 is 51. Of the 51 companies, 7 are excused from communicating the effects of transition to IFRS, due to three different reasons. Three companies only become listed in Eurolist during 2005; three companies have already been reporting their financial statements under IFRS in previous years and so do not have to explain the transition; finally, one company only presents non-consolidated financial statements. Hence, the final sample is comprised of 44 companies, 17 belonging to PSI-20, the Portuguese index composed by the 20 biggest listed companies[2]. Table 2 sums up the sample determination process.

Table 2: Sample determination

	All	PSI-20	Non PSI-20
Listed companies (Eurolist by Euronext Lisbon)	51	20	31
Listed only on 2005	(3)	(1)	(2)
Adopted IFRS in previous years	(3)	(2)	(1)
Publishes only individual accounts	(1)	-	(1)
Companies to be analysed	44	17	27

In Appendix I is provided the name of companies, economic sector and country of origin. Among the 44 companies, there are 3 foreign companies, 2 from Spain and 1 from Luxembourg. The division of the companies by economic sector is presented in

Table 3.

[2] Assessed by a composed measure of market capitalisation and trading volume.

Table 3: Economic Sector

FTSE Sector	N (%)
Basic industries	16 (36%)
Cyclical consumer goods	2 (5%)
Cyclical services	8 (18%)
Financials	7 (16%)
General industrials	2 (5%)
Information technologies	3 (7%)
Non-cyclical consumer goods	2 (5%)
Non-cyclical services	3 (7%)
Utilities	1 (2%)
Total	**44 (100%)**

5. RESULTS

As explained above, our final sample is comprised of 44 companies that were in the process of transition to IFRS and so that have to disclose to the market the impact of the changing of accounting normative till, at least, the disclosing of the 2005 first quarter financial statements. Applying the data collecting methodology described above, we reached to several results that are presented below.

5.1 Major Transition Impacts

One company communicates that it could not disclose any impact because it still has not finished the process of transition to IFRS and the first quarter consolidated financial statements are prepared and presented under the Portuguese standards. In this communication the company refers that till the end of September it will be able to disclose the impact of the transition in the 2004 financial statements and the 2005 interim financial statements under IFRS.

All the other 43 companies issue through some mean a communication explaining the impact of the transition to IFRS. Among these companies, 37 did communicate the impact of the transition as a material event, following the CMVM’s statement. This means that 6 companies do not comply with the requirement of CMVM, that is, while they communicated the impact of the transition, they did not disclose it as a Material event, having included it in the quarterly financial reporting information system.

Regarding the way of the communication, companies could adopt two possibilities: (1) issue a communication concerning only the impact of the transition or (2) seize the opportunity of the publication of the 2005 first quarter financial statements and include there the explanation of the impact of the transition to IFRS[3]. Twenty eight companies (65%), 9 PSI-20 companies and 19 non PSI-20 companies, issued a stand alone communication to the market explaining the impacts of the transition in their 2004 financial statements. Regarding the other fifteen companies, fourteen companies explained the impacts of the transition to IFRS in the first quarter financial reporting. Finally, regarding one company we cannot tell that it followed one of the two possibilities; in fact this is a stand alone case in which in its first quarter financial reporting the company does not explain the transition because it had already done that during 2004 financial reporting (interim and yearly financial reporting). Table 4 sums up these numbers.

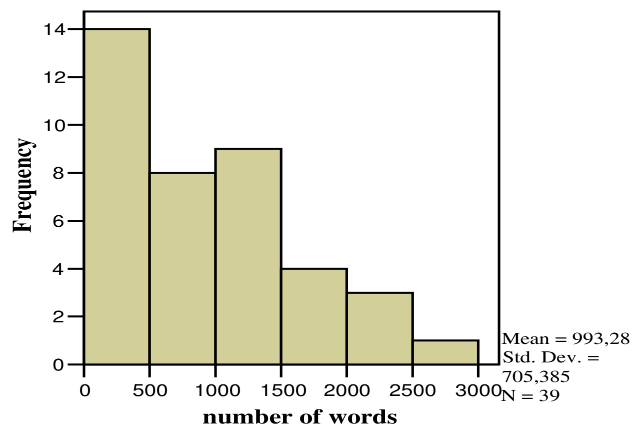
Table 4: Number of companies complying with CMVM's statement

	All	PSI-20	Non PSI-20
Sample companies	44	17	27
Did not make the transition	(1)	-	(1)
Communications of the impact from which:	43	17	26
As a material event	37 (86%)	14 (82%)	23 (88%)
Stand alone event	28	9	19
Within the 1T05 financial reporting	9	5	4
Within the 1T05 financial reporting	5 (12%)	3 (18%)	2 (8%)
During 2004 financial reporting	1 (2%)	-	1 (4%)

Moving on to the analysis of the content of the communications, we begin by analysing the extent of the communications of the transition to IFRS impact, measured by the number of words. The extent of the communications ranged from 0 words (Espirito Santo Financial Group disclosed only quantitative information) to 2934 words (Sacyr Vallehermoso), with a mean of 993 words. The frequency distribution of the number of words is presented in Figure 1.

[3] Whatever the way the company chooses, the communication should be disclosed as a Material Event.

Figure 1: Frequency distribution of the number of words



Only in four companies the information presented under IFRS was labeled as having been audited. Regarding the other companies, in two companies there was no information about this and in all other cases the information is referred as non-audited information (either the restatement of 2004 financial statements or the 2005 first quarter financial statements). Among these last cases, there are several companies that refer explicitly that the work of transition to IFRS was closely "accompanied" or "supervisioned" by an audit company, but still the information is not audited.

Regarding the quantitative information of the transition, CESR's recommendation includes the presentation of three reconciliations from previously used GAAP to IFRS. These are the reconciliation of shareholders' equity at the date of transition (1st January 2004) and at the end of the reporting period (31st December 2004) and of the profit and loss account. Analysing the communications, we conclude that the quantitative information disclosed is not the same in every company. Only 24 companies disclose all the reconciliations recommended by CESR and 7 companies do not present any reconciliation in their communication of the impacts of transition. Then, there are some companies that present only the reconciliation of shareholders' equity at 31st December 2004 and the profit and loss account reconciliation (6 companies), some that present the two reconciliations of shareholder's equity (beginning and end of 2004) and do not present the reconciliation of the profit and loss account (2 companies), then other 2 present only the reconciliation of shareholders' equity at the beginning of the period and do not present the other two, and finally one company presents only the reconciliation of the shareholders' equity at 31st December 2004, and another one presents the reconciliation of shareholders' equity at 1st January 2004 and of the profit and loss account. This scenario means there is great variability among the quantitative information disclosed by companies, harming the comparability of information.

Analysing the impacts on shareholders' equity and on profit and loss account reported by companies, we found that the majority of companies (22 companies) reported improvements of the equity figure as a result of the moving from Portuguese GAAP to IFRS. The same happened in the profit and loss account: the majority of companies (25 companies) reported improvement of earnings under IFRS. Among PSI-20 companies, this effect is more pronounced. 65% of companies disclosed a positive impact in shareholders' equity and 76% in the profit and loss account. These results can *a priori* be appointed as a signal of less conservatism[4] as defined by Basu (1997) of IFRS compared with Portuguese accounting standards. This issue is going to be deeply analysed in the next point.

Table 5: Reported impacts in Shareholders' equity and in Profit and loss account

	Shareholders' equity			Profit and loss account		
	Positive impact	Negative impact	Not disclosed	Positive impact	Negative impact	Not disclosed
PSI-20 companies	11	5	1	13	1	3
Other companies	11	11	5	12	10	5
All companies	22	16	6	25	11	8

Now we present the analysis of the issues pointed out by companies that required changes either on recognition or measurement policies or even regarding disclosure items as a consequence of the adoption of IFRS. The issues are presented on the next table and are divided according to what seemed to be the most important items (that affect more than 20% of the companies) – Panel A, and less important issues (that affect a smaller group of companies, but that can mean a lot for those specific companies) – Panel B.

[4] In literature we find two approaches of accounting conservatism: one from Basu (1997, p. 7-8) who defines conservatism as "accountants' tendency to require a higher degree of verification to recognize good news as gains than to recognize bad news as losses … Thus, conservatism results in a greater probability of timely accounting recognition of bad news than good news."; and other from Feltham and Ohlson (1995) for whom conservatism is an expectation that reported net assets will be less than market value in the long run.

Table 6: Accounting issues reported by companies

Panel A: Most reported items

	PSI-20		Non PSI-20		All	
	N	%	N	%	N	%
Intangible assets (except goodwill)	14	82%	24	92%	38	88%
Goodwill	14	82%	19	73%	33	77%
Tangible fixed assets	6	35%	20	77%	26	60%
Financial instruments	11	65%	13	50%	24	56%
Deferred taxes	8	47%	13	50%	21	49%
Deferred costs	8	47%	10	38%	18	42%
Employee benefits	6	35%	10	38%	16	37%
Provisions	6	35%	9	35%	15	35%
Extraordinary costs	5	29%	7	27%	12	28%
Hedge accounting	6	35%	4	15%	10	23%
Consolidation perimeter	2	12%	7	27%	9	21%
Investment property	2	12%	6	23%	8	19%

Panel A: Less reported items

	PSI-20		Non PSI-20		All	
	N	%	N	%	N	%
Effective interest rate	4	24%	3	12%	7	16%
Investments in associates (equity method)	2	12%	4	15%	6	14%
Special Purpose Entities	2	12%	3	12%	5	12%
Effect of changes in foreign exchange rate	2	12%	3	12%	5	12%
Financial Results	2	12%	3	12%	5	12%
Deferred income	5	29%	0	0%	5	12%
Inventories	1	6%	4	15%	5	12%
Stock options	3	18%	1	4%	4	9%
Credit risk	2	12%	2	8%	4	9%
Preference shares	2	12%	2	8%	4	9%
Self-constructed assets	3	18%	1	4%	4	9%
Treasury shares	0	0%	3	12%	3	7%
Bank risk reserve	1	6%	1	4%	2	5%
Liabilities	2	12%	0	0%	2	5%
Lease back	2	12%	0	0%	2	5%
Construction contracts	0	0%	2	8%	2	5%
Non monetary assets held for sale	0	0%	2	8%	2	5%
Dividends	1	6%	0	0%	1	2%
Government subsidies	1	6%	0	0%	1	2%
Financial leases			1	4%	1	2%
Insurance contracts	0	0%	1	4%	1	2%
Borrowing costs imputation	0	0%	1	4%	1	2%

With no doubt, the recognition of intangibles and the accounting treatment of goodwill resulting from business combinations are the two issues of great changes as a consequence of the move from Portuguese GAAP to IFRS. They are referred by 88% and 77% companies respectively as issues that affect shareholders' equity and profit and loss account. Other items that affect the majority of the companies are: financial instruments, tangible fixed assets and deferred taxes. Other still important group of issues that affect more than 25% of the companies includes: deferred costs, employee benefits, provisions, extraordinary results, hedge accounting, consolidation perimeter and investment property.

Several previously recognised in the balance sheet items, most of them intangible items, do not fulfill the recognition criteria of IFRS and so had to be derecognised. The end of the amortization of the goodwill resulting from business combinations and the impairment tests that are needed from now on are also big changes in accounting practices in that it affects almost all companies. Regarding financial instruments, as expected, financial companies are the ones that will be most affected by changes in accounting policies. In fact, this item shows an incidence of 100% among financial companies, while in non-financial companies it is referred by 57% of the companies.

There are other more specific items that do not affect a big number of companies, but still can mean a lot to some specific companies. These include among others, self-construct contracts, consolidation of SPE, investments in associates and special issues affecting financial companies such as effective interest rate, credit risk, bank risk reserves and insurance contracts.

According to a previous study (Lourenço and Morais (2004)) on the differences between Portuguese accounting standards and IFRS[5], the big differences between the two accounting normative are in inventories, investments in associates (equity method), tangible fixed assets (impairment losses), financial instruments and business combinations (goodwill and other items). Comparing our empirical results to this formal analysis, we conclude that, in general, our results are in line with expectations drawn from Lourenço and Morais (2004).

[5] Focusing on transition impacts in Portugal there are other *de jure* studies that compare Portuguese standards with IFRS trying to predict areas of major difficulties of the transition: Silva (2005), Lopes and Rodrigues (2006), Rodrigues and Guerreiro (2004), Morais and Lourenço (2005).

Nevertheless, this comparative analysis shows some surprising results. One regards to the inventories accounting treatment. Against the expectations drawn from standards, only 5 firms (12%) report inventories differences between the Portuguese GAAP and IFRS and these are not due to cost formula (the prohibition of LIFO in IAS 2 Inventories) but to measurement issues, namely regarding the calculation of industrial costs. Another not clearly confirmed expectation regards to investment in associates; though the differences between the standards, only 6 companies referred changes in the application of the equity method.

Another surprising result is the high percentage of companies that refers changes in deferred taxes, once Portuguese rules (Accounting Directive 28) are much the same as IAS 12 regarding this issue. A more deep analysis reveals that the reasons behind this are not directly linked to new accounting treatment but to other factors (Portuguese transitory rule for years prior to 2002, reclassification within the balance sheet and tax effects regarding accounting changes to IFRS). A different situation regards to financial companies, once the recognition of deferred taxes was not required by Portuguese accounting standards applying to these companies, meaning a real change in the accounting policy.

5.2 Conservatism Index

The comparison of the degrees of conservatism of different GAAPs has been object of several academic studies (Tsalavoutas and Evans (2007)). The context of transition to IFRS in Europe produces a unique setting to this type of studies and consequently, some studies are appearing using this methodology on the comparison of national GAAPs and IFRS (Tsalavoutas and Evans (2007) and Bertoni and De Rose (2006)). The research question addressed in this point regards the degree of conservatism of Portuguese GAAP compared with IFRS.

In order to find an answer to this research question, we adapt the index of Gray (1980) to express to relationship between Portuguese GAAP profits and IFRS profits in order to assess a neutral indicator of profit measurement behaviour of companies adopting different accounting GAAPs.

It is possible to calculate the ratio of Portuguese GAAP profits to IFRS profits as:

$$1-\left(\frac{R_{IFRS}-R_{Port}}{\left|R_{IFRS}\right|}\right)$$

Where R_{IFRS} = IFRS profits and R_{Port} = Portuguese Profits. Quoting from Gray (1980, p. 67) "The resulting ratio can be termed a "conservatism" index in that companies with a ratio of more than one would appear to employ accounting practices with outcomes which are relatively optimistic in relation to the yardstick, whereas companies with a ratio of less than one would appear to be relatively pessimistic or 'conservative'."

We calculate the ratios for each company using the above formula and prepare a frequency distribution. After that, we classify the ratios into nine categories from highly conservative or pessimistic category of < 0.50 to the less conservative or optimistic category of > 1.50. Then, we regroup the nine categories into three subgroups labeled pessimistic, neutral and optimistic. The pessimistic grouping is for conservatism ratios of < 0.95, whereas the optimistic grouping is for ratios of > 1.05. In order to allow some tolerance, it seems to us appropriate to consider the neutral grouping for ratios of 0.95 – 1.05.

Out of the 44 companies that communicate to market the transition impacts, only 35 disclose profits under IFRS and Portuguese GAAP at the end of 2004.

As we can see from Table 7, 70% of the Portuguese listed companies are in the neutral and pessimistic category meaning that the change to IFRS led to less conservative accounting practices.

Table 7. A Comparative Analysis of Profit–Measurement behaviour in Portuguese GAAP and IFRS GAAP

Reported Profits Classified Using An Index of Conservatism	Total of Disclosures	%
I. < 0.50	3	
II. >= 0.50 - < 0.74	7	
III. >= 0.75 - < 0.94	7	
Pessimistic (<0.95)	**17**	**49**
IV.>= 0.95 - < 0.99	2	
V. 1	5	
VI.>= 1.01 - < 1.05	0	
Neutral (0.95-1.05)	**7**	**20**
VII. >= 1.06 - < 1.25	3	
VIII. >= 1.26 - < 1.50	2	
IX. >= 1.50	6	
Optimistic (>1.50)	**11**	**31**
Total of Disclosures	**35**	**100**

6. DISCUSSION OF RESULTS

This paper analyses the communications to the market made by Portuguese listed companies about the transition to IFRS, in the context of CESR's and CMVM recommendations. We analyse the communications released between 1st January 2005 and 30th September 2005 by all listed companies and produce a broad picture of the transition process among Portuguese companies.

One company shows that it is not prepared to move to IFRS and presents the 1st quarter financial statements according to Portuguese GAAP against CESR's and CMVM's recommendation. All the other 43 companies issued, through some mean, a communication explaining the impact of the transition to IFRS. Six companies do not comply with CMVM's requirement regarding the form of the communication, not disclosing the information as a material event.

Regarding the extent of narrative disclosures, there is a high degree of variability among the communications, being the mean 993 words. Regarding the quantitative information, there is not a standard followed by every, or even the majority, of companies. 24 companies disclose all the reconciliations recommended by CESR and 7 companies do not present any reconciliation. The other companies present one or two reconciliations. That is, the majority of the companies do not disclose complete information of the impacts of the transition to IFRS. Now it remains to discover the reasons why companies do not disclose all the quantitative information: is it because they still did not have it (not having prepared the transition completely, almost at the end of 2005!) or is it because they do not want to disclose it to the market (perhaps it is not seen as good news or this is a mirror of the Portuguese cultural driven value of low transparency). Whatever the reasons behind, in our opinion, this scenario shows that the objectives of comparability, relevance and understandability stated by CESR were not achieved in Portugal.

Regarding the accounting changes, the recognition of intangibles and the accounting treatment of goodwill resulting from business combinations are the most referred issues as a consequence of the move from Portuguese GAAP to IFRS. Generally, these results are in line with the expected transition impacts based on previous *de jure* studies. Only concerning Inventories prior expectations were not confirmed by companies as a big issue of change.

This study has not the depth that we initially wished regarding the explanations and the justifications concerning the accounting transition impacts to Portuguese listed companies. This lack of profundity has one simple reason: the variability of the disclosures regarding the transition impact. As we stated before, there are firms that only report quantitative data, other that present only qualitative impacts and other that presented both but with different relevant extensions. For instance, concerning IAS 19 transition impacts, one firm reported the Profit and Loss statement and Shareholders equity statement reconciliations' with no explanation and another reported the explanation but not the quantitative impact in profit and loss and in shareholders' equity.

Additionally, in some situations several doubts arise to us: what are the real reasons for the disclosed impacts? Are they due to the new accounting rules of the IFRS or are companies seizing this (unique) opportunity to change balance sheet and profit and loss figures in the way they want? At least in one case we could confirm our suspicion near the company directly: one of the major accounting impact – reported to the market as an IFRS impact – had not any connection with the IFRS rules; in their own words, they just grab the opportunity to “rearrange” accounting figures.

This scenario calls attention to the importance of enforcement and companies’ supervision under the new accounting normative. Indeed, as several previous studies have documented, there is a high degree of non-compliance among IFRS adopters’ companies around the world (Glaum and Street (2003), Street and Gray (2001), Street and Gray (1999), Street *et al.* (1999)). In our opinion, without an effective enforcement and supervision system, nationally based, it is not possible to be totally confident on the accounting information produced by companies.

This study allows us to confirm the idea that the Portuguese accounting standards are more conservative than IFRS. Based on Gray’s (1980) “conservatism” index, our results show that 70% of the Portuguese listed companies are the category of neutral or pessimistic when reporting profit under Portuguese GAAP rather under IFRS.

This study provides a broad picture of the transition process to IFRS by the Portuguese listed companies. As such, it brings important contributes to regulators in their decision of extending the mandatory adoption of IAS/IFRS to non-listed companies and to individual accounts, highlighting potential problems that may come out from those transition processes. Additionally, this research is important for comparative studies either in a temporal basis or with other countries.

Appendix I – Eurolist by Euronext (Euronext Lisbon)

Name	FTSE Economic Sector		Country of origin
B.COM.PORTUGUES	Financials	PSI-20	Portugal
B.ESPIRITO SANTO	Financials	PSI-20	Portugal
BANCO BPI	Financials	PSI-20	Portugal
BANCO SANTANDER	Financials	Non PSI-20	Spain
BANIF-SGPS	Financials	Non PSI-20	Portugal
BRISA	Cyclical services	PSI-20	Portugal
CIMPOR,SGPS	Basic industries	PSI-20	Portugal
CIN	Basic industries	Non PSI-20	Portugal
CIRES	Basic industries	Non PSI-20	Portugal
COFINA,SGPS	Basic industries	PSI-20	Portugal
COMPTA	Information technologies	Non PSI-20	Portugal
CONTINENTE,SGPS	Non-cyclical services	Non PSI-20	Portugal
CORTICEIRA AMORIM	Non-cyclical consumer goods	PSI-20	Portugal
E.SANTO FINANCIAL	Financials	Non PSI-20	Luxembourg
EDP	Utilities	PSI-20	Portugal
EFACEC,SGPS	General industrials	Non PSI-20	Portugal
ESTORIL SOL P	Cyclical services	Non PSI-20	Portugal
FINIBANCO,SGPS	Financials	Non PSI-20	Portugal
FISIPE	Basic industries	Non PSI-20	Portugal
GESCARTAO	Basic industries	Non PSI-20	Portugal
IBERSOL,SGPS	Cyclical services	Non PSI-20	Portugal
IMOB.C GRAO PARA	Basic industries	Non PSI-20	Portugal
IMPRESA,SGPS	Cyclical services	PSI-20	Portugal
INAPA-INV.P.GESTAO	Basic industries	Non PSI-20	Portugal
MEDIA CAPITAL	Cyclical services	PSI-20	Portugal
MOTA ENGIL	Basic industries	PSI-20	Portugal
OREY ANTUNES ESC.	Cyclical services	Non PSI-20	Portugal
P.TELECOM	Non-cyclical services	PSI-20	Portugal
PAP.FERNANDES	Basic industries	Non PSI-20	Portugal
PARAREDE	Information technologies	PSI-20	Portugal
PORTUCEL	Basic industries	Non PSI-20	Portugal
PT MULTIMEDIA	Cyclical services	PSI-20	Portugal
REDITUS,SGPS	Information technologies	PSI-20	Portugal
S.CAETANO	General industrials	Non PSI-20	Portugal
S.COSTA	Basic industries	Non PSI-20	Portugal
SACYR VALLEHERMOSO	Basic industries	Non PSI-20	Spain
SAG GEST	Cyclical consumer goods	Non PSI-20	Portugal
SEMAPA	Basic industries	PSI-20	Portugal
SONAE INDUSTRIA	Basic industries	Non PSI-20	Portugal
SONAE,SGPS	Non-cyclical services	PSI-20	Portugal
SUMOLIS	Non-cyclical consumer goods	Non PSI-20	Portugal
TEIXEIRA DUARTE	Basic industries	Non PSI-20	Portugal
TERTIR ESC.	Cyclical services	Non PSI-20	Portugal
VAA VISTA ALEGRE	Cyclical consumer goods	Non PSI-20	Portugal

References

Abd-Elsalam, O. and P. Weetman (2003), "Introduction International Accounting Standards to an emerging capital market: relative familiarity and language effect in Egypt", *Journal of International Accounting, Auditing & Taxation*, Vol. 12, 1, pp. 63-84.

Aisbitt (2006), "Assessing the Effect of the Transition to IFRS on Equity: The Case of the FTSE 100", *Accounting in Europe*, Vol. 3, 1 pp. 117-133

Aisbitt, S. and P. Walton (2005), Preparing for IFRS: disclosures by FTSE 100 companies, European Accounting Association 2005 Conference (Gothenburg, Sweden).

Basu, S. (1997), "The conservatism principle and the asymmetric timeliness of earnings", *Journal of Accounting & Economics*, Vol. 24, 1, pp. 3-37.

Bellas, A., K. Toudas and K. Papadatos (2007), "The Consequences of Applying International Accounting Standards (IAS) to the Financial Statements of Greek Companies", 30th Annual Congress of European Accounting Association, Lisbon, Portugal, April 25-27, available at SSRN: http://ssrn.com/abstract =985048.

Bertoni, M. and B. De Rosa (2006), "Measuring balance sheet conservatism: empirical evidence from Italian first time adopters of IFRS", Emerging Issues in International Accounting and Business, Padua, Italy, July 20-22.

Callao, S., José Jarne and José Laínez (2007), "Adoption of IFRS in Spain: Effect on the comparability and relevance of financial reporting", *Journal of International Accounting, Auditing and Taxation*, Vol. 16, 2, pp. 148-178

CESR (2003), Recommendation for Additional Guidance Regarding the Transition to IFRS, CESR/03-323e.

CMVM (2005), Statement of 15th April, 2005 regarding the obligations of issuing and disclosing quarterly financial statements: a sum up of the applicable rules in 2005.

Feltham, G. A. and J. A. Ohlson (1995), "Valuation and Clean Surplus Accounting for Operating and Financial Activities", *Contemporary Accounting Research*, Vol. 11, 2, pp. 689-731.

Giner, B. and W. Rees (2005), "Introduction", *European Accounting Review*, Vol. 14, 1, pp. 95-99.

Glaum, M. and D. Street (2003), "Compliance with the Disclosure Requirements of Germany's New Market: IAS versus US GAAP", *Journal of International Financial Management & Accounting*, Vol. 14, 1, pp. 65-100.

Gray, S. J. (1980), "The impact of International Accounting Differences from a Security-Analysis Perspective: Some European Evidence", *Journal of Accounting Research*, Vol. 18, 1, pp. 64-76.

Jaruga, A., J. Fijalkowska, M. Jaruga-Baranowska and M. Frendzel (2007), "The Impact of IAS/IFRS on Polish Accounting Regulations and their Practical Implementation in Poland", *Accounting in Europe*, Vol. 4, 1, pp. 67-78.

Jermakowicz, E. (2004), "Effects of Adoption of International Financial Reporting Standards in Belgium: The Evidence from BEL-20 Companies", *Accounting in Europe*, Vol. 1, September, pp. 51-70.

Jones, T. and R. Luther (2005), "Anticipating the impact of IFRS on the management of German manufacturing companies: Some observations from a British perspective", *Accounting in Europe*, Vol. 2, pp. 165–194.

Lopes, P. and L. Rodrigues (2004), Accounting practices for financial instruments. How far are the Portuguese companies from IAS? (Working paper, Faculdade de Economia do Porto).

Lourenço, I. and A. Morais (2004), Aplicação das Normas do IASB em Portugal: as principais alterações, X Congresso de Contabilidade (Lisboa, Portugal).

Morais, A. and I. Lourenço, 2005. *Aplicação das normas do IASB em Portugal* (Publisher Team, Lisboa).

Perramon, J. and O. Amat (2006), "IFRS Introduction and Its Effect on Listed Companies in Spain", Economics Working Papers, no. 975, Universitat Pompeu Fabra, Department of Economics and Business.

Rodrigues, L. and M. Guerreiro, 2004. *A Convergência de Portugal com as Normas Internacionais de Contabilidade* (Publisher Team, Lisboa).

Silva, E. S., 2005. *Normas Internacionais de Contabilidade: Da Teoria à Prática* (Vida Económica, Lisboa).

Silva, F. and G. Couto (2007), "Measuring the Impact of International Financial Reporting Standards (IFRS) in Firm Reporting: The Case of Portugal", available at SSRN: http://ssrn.com/abstract=969972.

Street, D. and S. Gray (1999), "How wide is the gap between IASC and U.S. GAAP? Impact of the IASC comparability project and recent international developments", *Journal of International Accounting, Auditing & Taxation*, Vol. 8, 1, pp. 133-164.

Street, D. and S. Gray (2001), Observance of International Accounting Standards: Factors Explaining Non-compliance, ACCA Research Report nº 74, ed.: London Certified Accountants Educational Trust.

Street, D., S. Gray and S. Bryant (1999), "Acceptance and Observance of International Accounting Standards: An Empirical Study of Companies Claiming to Comply with IASs", *The International Journal of Accounting*, Vol. 34, 1, pp. 11-48.

Sucher, P. and I. Jindrichovska (2004), "Implementing IFRS: A Case Study of the Czech Republic", *Accounting in Europe*, Vol. 1, September, pp. 109-141.

Tsalavoutas, I. and L. Evans (2007), "Comparing International Financial Reporting Standards (IFRSs) and Greek GAAP: financial statements effects", Paper presented at Workshop on Accounting in Europe, ESSEC, Paris.

Vellam, I. (2004), "Implementation of International Accounting Standards in Poland: Can true convergence be achieved in practice?" *Accounting in Europe*, Vol. 1, September, pp. 143-167.

Weibenberger, B., A. Stahl and S. Vorstius (2004), "Changing from German GAAP to IFRS or USGAAP: A Survey of German Companies", *Accounting in Europe*, Vol. 1, September, pp. 169-189.

Recent FEP Working Papers

Nº 284	Argentino Pessoa, "*Educational Reform in Developing Countries: Private Involvement and Partnerships*", July 2008
Nº 283	Pedro Rui Mazeda Gil and Óscar Afonso, "*Technological-Knowledge Dynamics in Lab-Equipment Models of Quality Ladders*", July 2008
Nº 282	Filipe J. Sousa and Luís M. de Castro, "*How is the relationship significance brought about? A critical realist approach*", July 2008
Nº 281	Paula Neto; António Brandão and António Cerqueira, "*The Macroeconomic Determinants of Cross Border Mergers and Acquisitions and Greenfield Investments*", June 2008
Nº 280	Octávio Figueiredo, Paulo Guimarães and Douglas Woodward, "*Vertical Disintegration in Marshallian Industrial Districts*", June 2008
Nº 279	Jorge M. S. Valente, "*Beam search heuristics for quadratic earliness and tardiness scheduling*", June 2008
Nº 278	Nuno Torres and Óscar Afonso, "*Re-evaluating the impact of natural resources on economic growth*", June 2008
Nº 277	Inês Drumond, "*Bank Capital Requirements, Business Cycle Fluctuations and the Basel Accords: A Synthesis*", June 2008
Nº 276	Pedro Rui Mazeda Gil, "*Stylized Facts and Other Empirical Evidence on Firm Dynamics, Business Cycle and Growth*", May 2008
Nº 275	Teresa Dieguez and Aurora A.C. Teixeira, "*ICTs and Family Physicians Human Capital Upgrading. Delightful Chimera or Harsh Reality?*", May 2008
Nº 274	Teresa M. Fernandes, João F. Proença and P.K. Kannan, "*The Relationships in Marketing: Contribution of a Historical Perspective*", May 2008
Nº 273	Paulo Guimarães, Octávio Figueiredo and Douglas Woodward, "*Dartboard Tests for the Location Quotient*", April 2008
Nº 272	Rui Leite and Óscar Afonso, "*Effects of learning-by-doing, technology-adoption costs and wage inequality*", April 2008
Nº 271	Aurora A.C. Teixeira, "*National Systems of Innovation: a bibliometric appraisal*", April 2008
Nº 270	Tiago Mata, "*An uncertain dollar: The Wall Street Journal, the New York Times and the monetary crisis of 1971 to 1973*", April 2008
Nº 269	João Correia-da-Silva and Carlos Hervés-Beloso, "*General equilibrium with private state verification*", March 2008
Nº 268	Carlos Brito, "*Relationship Marketing: From Its Origins to the Current Streams of Research*", March 2008
Nº 267	Argentino Pessoa, "*Kuznets's Hypothesis And The Data Constraint*", February 2008
Nº 266	Argentino Pessoa, "*Public-Private Sector Partnerships In Developing Countries: Are Infrastructures Responding To The New Oda Strategy*", February 2008
Nº 265	Álvaro Aguiar and Ana Paula Ribeiro, "*Why Do Central Banks Push for Structural Reforms? The Case of a Reform in the Labor Market*", February 2008
Nº 264	Jorge M. S. Valente and José Fernando Gonçalves, "*A genetic algorithm approach for the single machine scheduling problem with linear earliness and quadratic tardiness penalties*", January 2008
Nº 263	Ana Oliveira-Brochado and Francisco Vitorino Martins, *"Determining the Number of Market Segments Using an Experimental Design"*, January 2008
Nº 262	Ana Oliveira-Brochado and Francisco Vitorino Martins, *"Segmentação de mercado e modelos mistura de regressão para variáveis normais"*, January 2008
Nº 261	Ana Oliveira-Brochado and Francisco Vitorino Martins, *"Aspectos Metodológicos da Segmentação de Mercado: Base de Segmentação e Métodos de Classificação"*, January 2008
Nº 260	João Correia-da-Silva, *"Agreeing to disagree in a countable space of equiprobable states"*, January 2008
Nº 259	Rui Cunha Marques and Ana Oliveira-Brochado, *"Comparing Airport regulation in*

	Europe: Is there need for a European Regulator?", December 2007
Nº 258	Ana Oliveira-Brochado and Rui Cunha Marques, *"Comparing alternative instruments to measure service quality in higher education"*, December 2007
Nº 257	Sara C. Santos Cruz and Aurora A.C. Teixeira, *"A new look into the evolution of clusters literature. A bibliometric exercise"*, December 2007
Nº 256	Aurora A.C. Teixeira, *"Entrepreneurial potential in Business and Engineering courses … why worry now?"*, December 2007
Nº 255	Alexandre Almeida and Aurora A.C. Teixeira, *"Does Patenting negatively impact on R&D investment?An international panel data assessment"*, December 2007
Nº 254	Argentino Pessoa, *"Innovation and Economic Growth: What is the actual importance of R&D?"*, November 2007
Nº 253	Gabriel Leite Mota, *"Why Should Happiness Have a Role in Welfare Economics? Happiness versus Orthodoxy and Capabilities"*, November 2007
Nº 252	Manuel Mota Freitas Martins, *"Terá a política monetária do Banco Central Europeu sido adequada para Portugal (1999-2007)?"*, November 2007
Nº 251	Argentino Pessoa, *"FDI and Host Country Productivity: A Review"*, October 2007
Nº 250	Jorge M. S. Valente, *"Beam search heuristics for the single machine scheduling problem with linear earliness and quadratic tardiness costs"*, October 2007
Nº 249	T. Andrade, G. Faria, V. Leite, F. Verona, M. Viegas, O.Afonso and P.B. Vasconcelos, *"Numerical solution of linear models in economics: The SP-DG model revisited"*, October 2007
Nº 248	Mário Alexandre P. M. Silva, *"Aghion And Howitt's Basic Schumpeterian Model Of Growth Through Creative Destruction: A Geometric Interpretation"*, October 2007
Nº 247	Octávio Figueiredo, Paulo Guimarães and Douglas Woodward, *"Localization Economies and Establishment Scale: A Dartboard Approach"*, September 2007
Nº 246	Dalila B. M. M. Fontes, Luís Camões and Fernando A. C. C. Fontes, *"Real Options using Markov Chains: an application to Production Capacity Decisions"*, July 2007
Nº 245	Fernando A. C. C. Fontes and Dalila B. M. M. Fontes, *"Optimal investment timing using Markov jump price processes"*, July 2007
Nº 244	Rui Henrique Alves and Óscar Afonso, *"Fiscal Federalism in the European Union: How Far Are We?"*, July 2007
Nº 243	Dalila B. M. M. Fontes, *"Computational results for Constrained Minimum Spanning Trees in Flow Networks"*, June 2007
Nº 242	Álvaro Aguiar and Inês Drumond, *"Business Cycle and Bank Capital: Monetary Policy Transmission under the Basel Accords"*, June 2007
Nº 241	Sandra T. Silva, Jorge M. S. Valente and Aurora A. C. Teixeira, *"An evolutionary model of industry dynamics and firms' institutional behavior with job search, bargaining and matching"*, April 2007
Nº 240	António Miguel Martins and Ana Paula Serra, *"Market Impact of International Sporting and Cultural Events"*, April 2007
Nº 239	Patrícia Teixeira Lopes and Lúcia Lima Rodrigues, *"Accounting for financial instruments: A comparison of European companies' practices with IAS 32 and IAS 39"*, March 2007
Nº 238	Jorge M. S. Valente, *"An exact approach for single machine scheduling with quadratic earliness and tardiness penalties"*, February 2007
Nº 237	Álvaro Aguiar and Ana Paula Ribeiro, *"Monetary Policy and the Political Support for a Labor Market Reform"*, February 2007

Editor: Sandra Silva (sandras@fep.up.pt)
Download available at:
http://www.fep.up.pt/investigacao/workingpapers/workingpapers.htm
also in http://ideas.repec.org/PaperSeries.html

www.fep.up.pt

Faculdade de Economia da Universidade do Porto
Rua Dr. Roberto Frias, 4200-464 Porto | Tel. 225 571 100
Tel. 225571100 | www.fep.up.pt