Preface

Accounting in Latin American (LATAM) countries has the potential to become an important topic for professionals and academics from all over the world. These countries have increased the importance of their role in the global economy and they have recently made an important step of moving towards the implementation of the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

Notwithstanding their economic importance and their recent effort of moving towards the implementation of IFRS, there is still a relatively low knowledge about the accounting issues within LATAM countries. Concerns related to the cultural features of LATAM countries and with the level of enforcement of IFRS in each country lead many to question the effect of IFRS adoption, and to call for further studies on the topic. This book seeks to fulfil this gap found in literature by discussing how accounting has developed over the last decade in LATAM countries and how these countries handled with the process of adopting IFRS, as well as how IFRS adoption impacted on these countries.

The widespread dissemination and application of IFRS in LATAM countries have been highly supported by local standard setters and other regional boards. The first chapter of this book presents an overview, on a twofold perspective, of the role of LATAM accounting bodies in the process of setting IFRS. Firstly, at the international level, it checks who are the LATAM bodies and persons who have a seat in the structure of IFRS Foundation and the IASB’s advisory bodies, highlighting their role and the required individual skills. Secondly, at the regional and local levels, it looks at the accountancy bodies in each LATAM country, to identify what they are doing regarding the process of convergence and adoption of IFRS.

The topics discussed in this chapter show that Brazil seems to assume the leading position and the most prominent role in the IFRS Foundation activities. Brazil is the only LATAM country represented in all the three-tier structure of the IFRS Foundation, both in the Monitoring Board and in the Trustees, as well as a member of the IASB. Then, Brazil is also directly represented in six IASB advisory boards.

At a regional level, in its role to achieve the convergence and/or the diffusion of international accounting in Central and South America, the Group of Latin American Accounting Standards (GLASS/GLENIF) have been developing an interesting list of activities since it participates in almost all calls made by the IASB to comment on accounting issues. Argentina, Mexico, Brazil and Venezuela, by this order, are the countries more engaged with all the activities of this body.

At local level, all LATAM countries have bodies with an interest in accounting. However, the diffusion of their roles and access to information related to their activities through their official websites is different when comparing these countries with each other. Mexico and Brazil are the only LATAM
Preface

countries providing information, through local bodies with an interest in accounting, about the contributions that those bodies sent directly to IASB apart from the ones they sent through GLASS/GLENIF.

The positions taken now, the frequency and the timing of the LATAM accounting bodies activities are recognized by other IFRS partners as very important and relevant in all processes around the conception and improvement of IFRS. Brazil has a special role not just because it is the biggest LATAM country but also because it is the first South American country making the full-adoption to IFRS.

Countries like Venezuela (in 2008), Chile (in 2009), Brazil and Ecuador (in 2010), El Salvador (in 2011), Argentina, Honduras and Mexico (in 2012), Colombia and Dominican Republic (in 2014), among others, definitely changed their requirements for corporate financial reporting trying to support economic development based on the application of IFRS, issued by the IASB.

The main objective of IASB is to develop a single set of high quality, understandable, enforceable and globally accepted accounting standards (the IFRS), pursuing the greater comparability of accounting practices among different countries. In this context, those companies that have adopted IFRS would be using the same accounting standards, which, theoretically, would reduce the difference between the accounting practices among different countries and, consequently, increase the comparability. Nevertheless, the IFRS adoption is widely discussed around the world and the literature suggest that there are motives to the existence of significant differences in the way as IFRS has been applied worldwide.

Given that the LATAM countries have adopted IFRS only recently, there are some doubts about whether the accounting practices in these countries are now harmonized. Based on prior literature (e.g. Nobes, 2006), it may be expected that national versions of IFRS may emerge in Latin America. The language, the translation process and terminology may be considered as obstacles to achieve the global comparability of financial statements across jurisdictions (Zeff, 2007). Additionally, there are some historical, economic and commercial aspects that may contribute to the emergence of differences in the way as IFRS are applied in each of the LATAM countries.

The second chapter reports an investigation developed in order to find whether the accounting practices in the five major Latin America countries that have already adopted IFRS (Brazil, Chile, Argentina, México and Peru) are nowadays harmonized or whether, even after the IFRS adoption, significant differences in accounting practices can be found.

The authors propose a classification of the accounting systems of these five countries and they identify the position of each country within this group of countries. The empirical findings provide evidence that the accounting practices in LATAM countries are really harmonized. Brazil, Chile, Argentina, México and Peru have now similar characteristics in regard of their accounting systems.

However, this study is based on the analysis of a list of overt options that can be found in IFRS and which are plainly specified as a choice (e.g. investment property measured at cost or fair value). Therefore, only the accounting practices that are easily observable could certainly be seen as homogeneous.

The question of whether the accounting practices that may not be as readily observable are harmonized between the LATAM countries is analysed in the third chapter of this book. An empirical study was developed in order to compare the level of earnings management in the first three Latin American IFRS adopters, Brazil, Chile and Peru, either before or after the IFRS adoption.

The results of this study show that firms from each of these three countries evidence different levels of earnings management before the IFRS adoption, and that those differences no longer remain after the adoption of IFRS. The results indicate that IFRS has made financial information more homogeneous and, therefore, enhanced information comparability within the Latin America.
Given the importance of Brazil as the largest economy in Latin America, with a population of approximately 200 million people and a capital market in constant development, a description of the process of IFRS adoption in this country is offered in chapter four.

This chapter describes how the Brazilian accounting model have been developed since 1940, when it was issued the first Company Act dealing with accounting in the modern era, as well as the main changes derived from the partial IFRS adoption, in 2008, and the full IFRS adoption, in 2010.

The adoption of IFRS in Brazil caused substantial changes in the Brazilian accounting model (BR GAAP). The main changes are related with the recognition and measurement of fixed tangible assets, goodwill and other intangible assets, investment property, share-based payments, financial instruments and biological assets, among others. The new presentation of financial statements also caused some changes in the format previously used in Brazil, and the international standard on operating segments also introduced a substantial innovation in the Brazilian accounting practices.

Four years after the formal adoption of full IFRS in Brazil, there is, of course, much to be overcome. Tax influences, previous accounting practices, subjectivity of standards, local adaptations, culture, behavior, enforcement and knowledge are some of the factors that would possibly limit the convergence to IFRS in Brazil.

However, it seems that the worst is over, and Brazil is nowadays beginning to mature its understanding of international standards. Both preparers, auditors, regulators and analysts have already demonstrated a higher level of knowledge about IFRS and, as new generations of accountants are entering the market already being taught based on the new accounting standards, changes in behavior seems to be more natural and intuitive.

Some of the benefits of IFRS adoption in Brazil, in terms of accounting quality, are already known. Chapter five describes some of these benefits. This chapter presents an empirical study developed with the aim of examining earnings distributions for discontinuities around thresholds before and after the IFRS adoption in Brazil. The empirical findings reveal that discontinuities exist, both before and after IFRS implementation, but there is a decrease in discontinuity. This study suggests that mandatory adoption of IFRS by Brazilian firms is associated with a decrease in earnings management, in particular during the period of full adoption of IFRS (post-2010).

One of the main challenges in applying IFRS in Brazil is that it requires a significant change where specific legal rules are replaced by principles, which requires managers to make judgments based on the economic reality irrespective of its legal form. Chapter six contributes with a further discussion on the challenges brought about the adoption of a system based on principles in a country with a civil-law tradition. This chapter highlights the effect of IFRS adoption in the treatment of shareholders’ rights in the stricto sensu law, its legal effect in the financial statements and the changes on the limits of the manager’s responsibility.

Another discussion around the adoption of IFRS in Brazil is related to the influence of tax-rules in the accounting practices. Chapter seven describes an empirical study that verifies if the legal enforcement by the government authorities created incentives for earnings management in Brazil. The results show a significant relationship between the increased tax rates and the measurement of technical accruals in the insurance industry, showing evidences of earnings management behavior in this industry specifically in the period in which the tax-rate have been increased.

Another challenge associated with the mandatory adoption of IFRS in Brazil is that it could require an increase in the cost faced by firms when preparing and reporting their financial statements. Chapter eight presents the findings of an empirical study on the effect of the IFRS adoption in the audit fees
supported by the Brazilian firms. This study provides evidence that the mandatory adoption of the IFRS in Brazil is associated with an expressive increase in the auditing fees faced by the listed firms.

In chapter nine is analyzed the influence of international accounting convergence in the level of earning management in both Brazilian and Chilean companies. To this end a descriptive study comprising both documental and quantitative analysis was undertaken between 2004 and 2012. The research based on a sample of 368 Brazilian and 246 Chilean firms listed in Thomson ONE Banker database.

The results showed that Chilean firms had higher levels of earnings management when compared to Brazilian companies and further, that in both countries the average discretionary accruals were negative; this suggests that accumulations might have been used for results reduction. Furthermore, there was also evidence that following the adoption of IFRS, discretionary accruals decreased in Brazil and Chile although reductions showed significant only in Chilean firms. The chapter ends up by concluding that the adoption of IFRS by Brazilian and Chilean firms might have contributed to the reduction of discretionary accruals and, hence, of the earning management, particularly in Chile.

Chapter ten seeks to analyze how accounting system evolved in Peru and whether small and medium sized enterprises (SMEs) are presently complying with IFRS. A brief history of Peruvian accounting is provided as a background of the empirical study and discussed the role of the Peruvian Accounting Standards Board (CNC as acronym in Spanish) in the implementation of IFRSs for SMEs. Apparently, in Peru there is a variety of financial standards that companies must comply according to their size and industry. For example, whereas listed companies comply with IFRS issued by the IASB, big private companies must follow IFRS approved by the CNC and SMEs must follow IFRS for SMEs.

The hypothesis “Although the Peruvian Accounting Standards Board (CNC) adopted IFRS for SMEs, in reality SMEs do NOT comply with them since they use accounting records and prepare financial statements for tax purposes, but not for decision making regarding investments, loan approvals, or in general, for managerial and financial decisions” is put forward. The research relied on both primary and secondary data gathered between March and April, 2013. In order to generate primary data 120 surveys were sent to SMEs and interviews were conducted to key actors (top executives, personnel in a regulatory institution, big four accounting firms and a dean of a top accounting school) in the Peruvian accounting system.

The research evidenced that the hypothesis under analysis should be rejected as most of the Peruvian companies do not apply IFRS for SMEs. The survey indicates that more than 70% of the companies prepare their financial statements according to legal and tributary norms and less than one fourth according to IFRS, despite the adoption of IFRS being legally mandatory. Additionally the research shows that SMEs use accounting records for tax purposes and not for decision making regarding investments, loan approvals or in general managerial or financial purposes, and that accountants lack of knowledge, training, experience and incentives to incorporate IFRS in practice.

The study of IFRS in SMEs continues with chapter eleven. This chapter aims is to discuss the different approaches (or models) of harmonization to IFRS based on the experiences undergone by seven LATAM countries (Argentina, Brazil, Chile, Colombia, Peru, Uruguay and Venezuela). Harmonization models may be grouped into five categories: (i) maintenance of local financial reporting standards; (ii) adaptation of IFRS to local standards; (iii) full or partial adoption of IFRS; (iv) adoption of another country’s standards; and (v) convergence to diminish differences between local standards and IFRS. The research evidences that all seven of the countries embraced in the study either have adopted IFRS for SMEs or have developed plans to do so over the past six years.
Chapter twelve investigates how the adoption of IFRS in Brazil has been affected by the cultural issues reported by Gray (1988). To this end, financial reports of 120 SMEs located in state of Maranhão in Brazil, were analyzed in the period between 2008-2013. Likewise interviews with accountants and managers of these firms were conducted in order to: (i) identify the stage of IFRS implementation of firms; (ii) the main problems companies’ faced when implementing IFRS; and (iii) how difficulties might relate with cultural aspects. The study revealed that firms have been delaying IFRS adoption, and that accountants and managers are using tax rules rather than IFRS. Managers seem to not use financial reporting when making decisions, being accounting mainly prepared for tax purposes.

Similarly, chapter thirteen examines IFRS for SMEs in a specific state of Brazil (Mato Grosso). Specifically this chapter seeks to investigate the perception of accountants on continuing professional education on IFRS for SMEs. A questionnaire was prepared to collect evidence on the topic. About 302 responses from a population of 1597 financial services companies were gathered.

The findings of the investigation indicate that accountants are not well prepared to perform accounting practice according to IFRS for SMEs partially due to the insufficiency of courses in the new accounting standard in the region of Mato Grosso. Furthermore, the research showed that accountants’ perception on the need of getting continuing professional education on IFRS for SMES is high. The Regional Accounting Council and universities are pointed out as the main agents in the process of assuring training to accountants on IFRS for SMEs; additionally, accountants recognize the importance of establishing mandatory continuing professional education to all accounting professionals, and that training would improve not only their work performance, employability, prestige, respectability and recognition but also, their satisfaction when performing accounting activities. Perceptions of accountants also indicate that more knowledge gained through continuing education could lead to firms’ better financial performance, and to an increase in their level of income.