Chapter 6
Challenges in Applying IFRS in a Civil Law Tradition: The Example of Brazil

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ABSTRACT

As part of the Common Law, IFRS represents a significant cultural change in Brazil, a Civil Law country, for both accounting and law. In 2010 (the first adoption of IFRS), Brazilian accounting legislation fully adopted the International Financial Reporting Standards (IFRS) as its standard for accounting practices. Accordingly, its adoption by Brazil represents a challenge, since it is a significant cultural change, because of its insertion into a Civil Law system country. First of all, in accounting terms, this chapter comments how the specific rules were changed by principles with a big importance for the administration judgments, in this way, the managers’ subjectivity. Additionally, considering that in a Civil Law system, especially in Brazil, this chapter presents that there are many shareholders’ rights in the stricto sensu law, the legal impacts of the financial statements must be analyzed, including the manager’s responsibility.

INTRODUCTION

As we know, according to the IFRS, financial statements are developed based on the judgment of a company’s administrators and on the primacy of essence over form. The recognition, the measurement and the disclosure of economic events in accounting, as well as all their legal impacts, obey business criteria, without necessarily having a direct legal reference. Therefore, the liability of a company and its administrators emanates from their own decisions.

Regarding the Brazilian legal system, the situation is different – and the challenge is here –, because the Federal Constitution has an express article that states that “nobody will be obliged to do or not do something if not dictated by law” (article 5, II). Despite contractual freedom being guaranteed, including at the constitutional level (article 5, XIII), stricto sensu law covers several broad situations pertaining to agreements and commercial relations.

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Because of this situation, the liability of a company and its administrators largely emanates directly from the law, and, in case of omission, it is possible that some rights are not recognized and assured, like, for example: the assets registered by the company, regardless of propriety, may or may not be the object of contractual guarantee (leasing); debentures registered in the owner’s equity of the company may or may not influence the level of indebtedness for the fulfillment of the bank loan clauses (hybrid instrument); how to evaluate a single and the same operation with distinctive values for creditor and debtor (adjust the present value).

In case of omission of Brazilian law, it is possible that some company and administrators’ rights are not recognized.

Furthermore, several shareholders’, creditors’, investors’ and other stakeholders’ rights that are based on rules (specific, direct and express rules), practices and financial statements are expressly covered by law. Considering that Brazil is a Civil Law country, it is necessary that this accounting basis of rights is similarly covered by law, at least along general lines. Thus, *stricto sensu* law should govern regulatory accounting rules, with the objective of ensuring legal safety to the effects of financial statements.

Not by chance the Brazilian corporate law dedicates a full chapter to bookkeeping and several provisions to inspection, accountability and disclosure of trade books, all this associated to financial statements. Therefore, from the legal standpoint the initial legal interests to be protected by the accounting regulation are the corporate relationship and the assured continuity of the company. The first challenge, thus, is to write a *strictu sensu* law that supports IFRS bases, as the accounting principles, the administration’s judgment and the essence over the form.

Legally speaking, the usefulness of accounting is not limited to businesses carried out between shareholders, perhaps the most prominent legal interest protected by the accounting law – which in a way is not limited to the calculation of taxes. The IFRS and its two main principles that are closely related to the law: judgment and substance over legal form. In the first case, the practice and manner of decision making according to law (judgment) are adopted for the bookkeeping (recognition, measurement and disclosure); in the second, financial statements seek to present events and economic operations actually occurred in the concrete world, independently of the equivalent formalized legal relationship (economic substance portrayed in the formalized legal act) whether adequate or not.

Due to the adoption of these principles, the legal interest protected by the accounting law is expanded, extrapolating corporate relations and becoming instrument of defense and proof in almost all corporate legal relationships, whoever be the other party (stakeholder or accounting user). In this sense, the following cases should be mentioned:

(i) Contractual guarantee: in order to record fixed assets the property right is no longer necessary (such as in leasing);
(ii) Bookkeeping of debts: the absence of accounting entry of debts, even debts under litigation, may provide a higher distribution of dividends to partners thus harming the right of creditors, once the company disposes of financial resources that could ensure payment;
(iii) Covenant fulfillment: loan agreements normally have performance clauses which devices are decisively influenced by the accounting criteria adopted by the company management;
(iv) Public biddings: the judgment turns accounting into a subjective matter – which in principle is not harming; quite the other way around – making it difficult to compare the bidders’ financial information.
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