De facto or *de jure* Harmonisation: How Much Dis(harmonised) Are the Entities in an IFRS Environment?

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Abstract: This paper uses exploratory analysis to seek evidence of accounting practices in a harmonized environment that mitigates the comparability of financial reporting by selecting an exemplary topic from different cases. The topics include the treatment given by entities to those cases not prescribed in the standards, but traditionally used by entities, cases prescribed by standards, but in a way that is not specific or clear enough, and, finally, cases where standards allow alternative accounting treatments. The consolidated reports and accounts of the entities included in the main Euronext Lisbon index for the years 2019 and 2020 were assessed. It was found that the accounting practices adopted by the entities are diverse, with different implications within the options that are reflected in the recognition and presentation of expenses and incomes. This type of research allows broadening the discussion around the implementation of effective measures to reduce the subjectivity associated with the adoption and application of standards to reach higher levels of *de facto* harmonisation or convergence. It is expected that the proposed analysis can contribute to drawing the attention of standard-setters and regulators of financial reporting to the potential constraints associated with the high flexibility of, or gaps in, International Financial Reporting Standards.

1 INTRODUCTION

The main objective of international accounting harmonisation is the comparability of financial reporting (Nobes, 2013), which seeks to promote the compatibility of accounting practices adopted by different countries and reduce the existing conceptual differences (Barlev & Haddad, 2007).

The international accounting harmonisation, based on the adoption of the International Accounting Standards (IAS) and the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), hereinafter simplified referred to as IFRS, is essentially based on this idea of global comparability of financial reporting (IFRS *Foundation*, 2021).

This was also the objective behind the requirement imposed to entities with securities traded in any regulated market in the European Union (EU), through Regulation (EC) No. 1606/2002 of the European Parliament and the Council of 19 July 2002, to present their consolidated financial statements under IFRS from 2005. This regulation also provided the option to include other entities in its scope, namely the consolidated accounts of unlisted entities or individual accounts of entities within a group that, by mandatory or optional reasons, applies IFRS. Consequently, this important step, taken by the EU, resulted in a catalyst effect of the full adoption or convergence of domestic standards to IFRS among several jurisdictions around the world (Palea, 2013).

Portugal is one of the examples of countries that have undergone convergence processes, through the introduction of the Accounting Standardization System (SNC, in the Portuguese Acronym), adopted under Decree-Law No. 158/2009 of July 13, for entities that are in the mandatory or optional scope of Regulation (EC) 1606/2002.

Notwithstanding, and despite the strong dissemination towards IFRS adoption or convergence, the comparability from these processes should not be seen as full. Different reasons can act as mitigating factors in this context, even in a harmonised environment through a standardisation process. The literature points out a divergence between the so-called *de jure* and *de facto* harmonisation. The first refers to the standardization of accounting regulation through regulation processes, while the second concerns how a particular

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matter is applied in practice (Alexander & Nobes, 2010; Bengtsson, 2021).

Thus, to make the objectives underlying the harmonisation process easily achieved, namely the effective comparability of financial reporting at an international level, it is important to understand the effective impacts of IFRS adoption on accounting practices based on professional judgment (*de facto* harmonisation).

This paper, therefore, uses an exploratory analysis to materialize the existence of different accounting practices, which have effects on comparability from high flexibility or gaps that led to dissimilar interpretations and judgments. Evidence was directly obtained from the financial report of listed entities in PSI 20, Euronext Lisbon benchmark index. Three areas of analysis that potentially generate divergences between the options followed by entities were then selected.

More specifically, the paper seeks evidence, through some selected examples, of issues that come from accounting practices in a harmonisation environment in IFRS that mitigate the comparability of financial reporting. It is expected that this analysis can contribute to the identification of possible divergences in accounting practices amongst entities, attracting the attention of standard-setters and regulators of financial reporting to the potential constraints associated with the high flexibility of, or gaps in, IFRS. Also, it intends to shed light on this topic and, consequently, to provide a path of analysis that can be used for future research in this field, as it has not been fully explored yet (Nobes, 2013).

The paper is structured in three sections, besides this introduction. The following section presents the issues identified in the literature that seek to explain the differences between *de facto* and *de jure* harmonisation. Section three presents the evidence obtained from the proposed analysis defined for this aim. Finally, the fourth section presents the conclusions and final considerations.

2 *De facto* VERSUS *de jure* HARMONISATION

The comparability of financial reporting is one of the main objectives and drivers of the international accounting harmonisation process (Nobes, 2013). Thus, the adoption of the IFRS issued by IASB through *de jure* harmonisation contributes to that goal. The problem surrounding the proper materialization of the principles behind those standards and, consequently, the related accounting practices, have been a topic of debate among the scientific community in the accounting area, given their consequences in the comparability of financial reporting. Then, the specific issue that arises is the analysis of *de facto* harmonisation through adoption or convergence with IFRS.

The discussions on the differences between the financial reporting by entities from different countries are not recent. Even before the emergence of the International Accounting Standards Committee (IASC), this topic was initially proposed by Mueller (1967), being subsequently developed by Nobes (1983), through the international accounting systems classification models. Despite the significant scope of the international harmonisation process nowadays, the discussion about the reasons behind the differences around international financial reporting should not be overlooked.

Aligned with this, Nobes (2013) argues that the analysis of the countries' classification around accounting systems remains relevant, suggesting that, in practice, differences in financial reporting can arise from issues as diverse as language and interpretation, local regulation, as well as the existing options under IFRS.

For instance, the influence of culture is behind the preparers' decisions and interpretations in matters such as recognition, measurement, and disclosure (Gray, 1988; Zarzeski, 1996; Acheampong, 2021; Laaksonen 2021; Albuquerque & Pereira, 2022; Gierusz et al., 2022). Some studies specifically cover the difficulties associated with the translation and interpretation of some specific concepts under IFRS, such as those related to verbal probability expressions (Doupnik & Richter, 2003; Zeff, 2007; Kolesnik et al., 2019; Hellman & Patel, 2021; Hellman et al., 2021). Furthermore, countries' institutional and economic factors may be included as explanatory variables (Chand, Patel, & Day, 2008). Therefore, the set of these factors may cause divergent interpretations of the existing concepts in IFRS that are ultimately reflected in the financial report.

As IFRS are principles-based standards, conversely to the rules-based ones, the decisions in specific accounting matters are subject to professional judgment. This is also pointed out as a mitigating element of comparability, particularly in a context of greater uncertainty and a lower level of verifiability (Chen & Gong, 2020). In addition, the alternative treatments provided for in IFRS contribute to the differences in financial reporting, with the standard-setter bodies acting as the entities that can introduce changes to act towards their elimination (Nobes, 2013).

Nobes (2020), in a recent paper, identified four unavoidable topics from the last four decades in the field of international financial reporting research, namely: i) studies on the process of measuring *de facto* harmonisation, with emphasis on the indices developed by van de Tars (1988); ii) reconciliations to measure the differences between sets of accounting and financial reporting standards, initiated by Weetman and Gray (1991); iii) the assessment of the level of connection between the tax system and the financial reporting in several countries, highlighting in this context the Lamb, Nobes and Roberts's (1998) model; iv) finally, and as the most recent area, the analysis of practices in IFRS that can be different amongst countries or sectors, following the suggestion by Nobes (2006).

Furthermore, Nobes (2013) highlights that the analysis of the impact from different options used by entities that adopt IFRS is a relevant research theme that has been underestimated by researchers, and it is possible to question whether international comparability is, in fact, the objective of those who use them.

Empirically, it is possible to observe the maintenance of international accounting diversity, even in an environment of broad adoption of IFRS around the world (Kvaal & Nobes, 2012).

3 EMPIRICAL ANALYSIS

This paper uses data from Euronext Lisbon to perform an exploratory analysis on accounting practices that illustrate the underlying issues on *de jure versus de facto* harmonisation. For this purpose, this section is divided into two subsections. The first one presents an overview of the data and entities assessed. The second one provides analysis performed and discusses the obtained results.

3.1 Data and Entities Assessed

Euronext Lisbon is the Portuguese stock exchange. As usual in similar markets, its organization includes an index for all entities, the PSI All-Share Index, and an index composed by the most representative entities, the PSI 20. This index integrates more than 98% of the total market capitalization, despite contemplating less than half of the entities listed in the PSI All-Share Index (Euronext, 2021).

Table 1 shows the entities that integrate PSI 20 and the corresponding activity sector they are included, based on the 4-digits (super sector) of Industry Classification Benchmark (ICB).

Table 1: Entities that integrate PSI 20 and its sectors on 30 September 2021.

Entities	Industry
Altri	Basic resources
Ramada	
Semapa	
Navigator	
Corticeira Amorim	Industrial goods and services
CTT	
EDP	Utilities
EDP Renewables	
Greenvolt	
REN	
Galp	Energy
Mota Engil	Construction and materials
Pharol	Telecommunications
NOS	
Novabase	Technology
J Martins	Personal Care, drug, and grocery stores
Sonae	
Ibersol	Travel and leisure
BCP	Banks

Source: Euronext (2021)

The proposed analysis for this paper is based on consolidated reports and accounts of 31 December 2019 and 2020. This information was gathered from the websites of the entities included in PSI 20, which is currently composed of 19 entities. From the ICB, evidence will be sought, in the subsequent analysis, on different patterns of accounting practice according to the entities' activity sector.

3.2 Accounting Practices Identified

Aligned with research suggestion by Nobes (2013), this paper aims to identify the treatment given by the entities to distinct situations, through the selection of an exemplary topic by case as follows:

1. **cases not prescribed under IFRS**, but which accounting practices traditionally point out to a possible procedure, especially in Portugal (subsubsection 3.2.1).
2. **cases prescribed under IFRS, but not sufficiently clear (or particularly detailed)**. In other words, there is only general guidance on their impact on accounts, neglecting, however, the specific procedure to be adopted regarding the items of the financial statements to be affected by such events (subsubsection 3.2.2).

3. **cases in which IFRS prescribes alternative approaches or accounting treatments**, leaving it up to the preparers' discretion to choose the most appropriate one (subsubsection 3.2.3).

The next subsubsections provide the findings from the analysis performed.

3.2.1 Cases Not Prescribed Under IFRS

For the analysis of the non-prescribed treatments, it was selected the cases related to the treatment of the costs potentially capitalised in the scope of non-current assets, such as tangible and intangible assets. Some costs may be capitalised and, consequently, they are included in the assets' carrying amount. For instance, when an entity is developing a non-current asset such as a building or intangible assets within the development phase, some incurred costs to complete those assets can be capitalised, instead of being charged as expenses.

However, IFRS does not prescribe the treatment to be observed regarding the capitalization of such costs. From this gap, entities may adopt the following treatments to include them in the assets carrying amount: i) Through a direct capitalisation; ii) Through a direct reduction of the expenses, by the amount to be capitalised; iii) Using an income account that, indirectly, mitigates the impact of these expenses on the profit or loss for the period.

Regardless of the procedure used, the profit or loss will be equivalent. However, in the first two cases, the income statement (IS) to be presented will be precisely the same. In the latter, the IS will reflect the different types of expenses for the total amount charged as proposed in ii), depending on their nature. Also, an income will be recognised, to mitigate the impact of the costs to be capitalised on the profit or loss for the period. This income may be either an item specifically identified as capitalised costs (CC) in the face of the IS or it may be included in other types of income accounts, such as "other incomes". Furthermore, a mixed approach is also possible.

It should be said that the item CC is not provided for in IFRS. Nevertheless, in the Portuguese case, it is included in the code of accounts, following in this regard what was previously prescribed by the previous national regulation, the Official Accounting Plan (POC, in the Portuguese acronym), which was in force for about three decades. In this regard, it is important to recall the suggestion by Nobes (2013), from which the local accounting practices tend to prevail over IFRS.

To identify how the costs to be capitalised are recognised, the following items (I) were gathered:

i) the CC was presented as a properly identifiable item (CC) in the IS (I1);

ii) if not, there was evidence in the notes of these costs through an income account (I2) or by reducing expenses (I3);

iii) finally, there was evidence of capitalisation of costs, but it was not possible to identify, through the IS or in the notes, the specific accounting treatment given to such cases (I4).

Table 2 summarizes the evidence on this topic by activity sector, identifying as "not applicable" (NA) those cases in which it was not possible to assure whether there was capitalisation of costs in the periods under assessment.

Table 2: Practices for the recognition of CC for the PSI 20 entities.

Activity sector (number of entities)	**I1**	**I2**	**I3**	**I4**	**NA**
Basic resources (4)		2			2
Industrial goods and services (2)				1	1
Utilities (4)			2		2
Energy (1)					1
Construction and materials (1)					1
Telecommunications (2)					2
Technology (1)				1	
Personal Care, drug, and grocery stores (2)		1		1	
Travel and leisure (1)					1
Banks (1)					1
Total (19)	0	3	2	3	11

For the PSI 20 entities, although accounting policies provide for the capitalization of costs, there are no references to the specific way of recognition adopted. None of the cases showed the CC as an item in the IS (I1).

Notwithstanding, there were three entities for which this item is identified as part of the "Other income" (I2) and two other cases that mentioned the reduction of expenses to capitalise costs in non-current assets carrying amount (I3).

On the other hand, it was also seen three entities for which it was not possible to identify the practice followed (I4). Two out three of these entities indicated in the notes the capitalization of internal resources in the intangible assets carrying amount.

However, they did not present any evidence of the procedure used. The remaining entity, despite presenting the CC item as part of “other income”, identifies, at the same time, the reduction of some expenses by the amount capitalised.

For most cases, however, there is no information on capitalization of costs, despite the provisions of the accounting policy in some cases. Furthermore, it was not possible to understand by reading the notes whether this happened or not (NA).

Finally, there was no evidence that the activity sector is an explanatory factor of the practice followed by entities. It can be stressed, however, that two entities in the utility sector, that belong to the same group, mentioned the procedure of reducing the expenses, so this can be likely seen as the harmonizing factor.

3.2.2 Cases Prescribed under IFRS, but Not Sufficiently Clear

Within this topic, the cases related to adjustments to inventories were selected. IAS 2 Inventories prescribes that the inventories are measured at the lowest amount between the acquisition cost and net realisable value (NRV). However, whenever it is necessary to recognise an expense for those cases, the IAS 2 does not establish the item in the IS to be used. Conversely, in the Portuguese case, such adjustments are recognised as impairment losses in inventories (ILI).

Thus, the following items were assessed as regards this subject:

i) adjustments in inventories were presented as a properly identifiable item (ILI) in the IS (I1);

ii) otherwise, if the item was not identifiable in the IS, there was evidence in the notes that they were considered as a different item of impairment losses (I2), as other expenses (I3), or as cost of inventories sold (I4);

iii) finally, it was not possible to identify, through the IS or in the notes, the specific accounting treatment given to such cases (I5).

Table 3 summarizes the evidence on this theme by activity sector, identifying as NA those cases in which the entities had not presented inventories or there was any indication of such adjustments in the periods under assessment.

None out nineteen of these entities identified this expense as ILI in the IS (I1).

On the other hand, based on the information provided in the notes, four entities had classified these adjustments as impairment losses, either together with other types of impairment losses or in generic items, such as "impairment losses" or "provisions and impairment losses" (I2). Two entities recognised these expenses in items other than the ones previously mentioned (I3). One of them included this adjustment as "other operating expenses and losses (net of reversals)". The other one included this item as "other operating expenses and losses" (the impairment losses) and as "other operating income and gains" (in case of reversals). However, it was also possible to identify four situations in which the adjustment is recognised as the "cost of sales" or "cost of goods sold and materials consumed" (I4).

It was also found three entities in which, despite the reference for adjustments on inventories in the period, there was no evidence regarding the item where the adjustments were included in the IS (I5). This may be explained by the fact that only the reconciliation for the initial and final balance of inventories in the statement of financial position was provided.

Finally, in six out of nineteen cases there was no evidence of inventories or impairment losses during the periods under assessment.

Table 3: Practices for the recognition of adjustments on inventories for the PSI 20 entities.

Activity sector (number of entities)	I1	I2	I3	I4	I5	NA
Basic resources (4)		2	2			
Industrial goods and services (2)				1	1	
Utilities (4)					1	3
Energy (1)				1		
Construction and materials (1)		1				
Telecommu-nications (2)				1		1
Technology (1)		1				
Personal care, drugs, and grocery stores (2)				1	1	
Travel and leisure (1)						1
Banks (1)						1
Totals (19)	0	4	2	4	3	6

The analysis by activity sectors, once again, does not allow to identify any indication of similar accounting practices by sector.

3.2.3 Cases Prescribed Under IFRS with Alternative Treatments

For this last topic, it was selected the different approaches proposed to treat the government grants.

IAS 20 Accounting for government grants and disclosure of government assistance prescribes the accounting treatment for grants relating to assets and income. A grant relating to income, also known as operating grants (OG), should be recognised in profit or loss on a systematic basis during the periods in which the expenses that the grants are intended to offset are recognised. Notwithstanding, two alternative accounting treatments are possible: either as an income (separately or included in other items of incomes in the IS) or as a reduction of the expenses that the income aim to offset. A grant relating to assets, also known as investment grants (IG), also has two possible approaches. More specifically, it may be initially recognised either as deferred income or deducted from the carrying amount of the related asset.

Subsequently, the income should be attributed to the profit or loss for the period on a systematic basis over the useful life of the asset. However, it is not sufficiently clear, in the first case, whether it should be included as an income or reducing the depreciation/amortization expense, which means an implicitly effect on the amount of that expense regarding the assets to which the grant is related.

Then, within this theme, the following items were assessed:

i) OG and IG were evidenced as such in IS (I1);

ii) otherwise, in the case of OG, if it was recognized as an income (I2) or as a reduction of the related expenses (I3);

iii) otherwise, in the case of IG, if it was periodically recognized as income (I4) or as a reduction of the depreciation or amortization expenses (I5) or, finally, if it was initially deducted from the related asset (I6);

iv) it was not possible to identify, through the IS or in the notes, the specific accounting treatment given to such cases (I7).

Table 4 summarizes the evidence on OG by activity sector, identifying as NA the cases in which it was not possible to identify the existence of those grants in the periods under assessment.

None of the entities specifically identified the OG as such in the IS (I1).

On the other hand, nine out of nineteen entities recognised this item as "other income" (I2), which was the most usual accounting practice for some sectors, such as the basic resources and industrial goods and services. Conversely, two entities choose to recognise the OG as a reduction of the expenses with which they are related, for instance, the "staff costs" (I3).

It should be noted that for three entities, although the existence of some information in this sense, it was not clear the treatment given to OG, being found an imprecise mention such as that "the operating grants are recognised in the income statements in the same period in which the associated expenses are incurred" (I7).

Finally, five cases were classified as NA regarding OG, based on the information assessed.

Table 4: Practices for the recognition of OG for the PSI 20 entities.

Activity sector (number of entities)	I1	I2	I3	I7	NA
Basic resources (4)		4			
Industrial goods and services (2)		2			
Utilities (4)		1		1	2
Energy (1)					1
Construction and materials (1)			1		
Telecommunications (2)			1		1
Technology (1)				1	
Personal care, drugs, and grocery store (2)		1		1	
Travel and leisure (1)		1			
Banks (1)					1
Totals (19)	0	9	2	3	5

Following, Table 5 summarizes the data related to IG.

As for IG, it can be concluded that eleven out of nineteen entities recognised this item as a deferred income, of which seven systematically imputed it to other income (I4), and four choose to deduct it from the depreciation or amortization expenses (I5).

There is also a single entity that uses the alternative option of deducting the IG to the asset carrying amount, stating that "tangible assets are initially recognised at the acquisition cost, deducted from accumulated depreciation, investment grants and impairment losses, whenever applicable" (I6).

There were also four cases in which the information in the notes was not sufficiently clear on the recognition of such grants, only mentioning that they were initially recognised as "non-current liabilities, and subsequently recognised in the IS during the estimated life of the acquired assets " (I7).

Finally, three cases were classified as NA as regards IG, based on the information assessed.

Table 5: Practices for the recognition of IG for the PSI 20 entities.

Activity sector (number of entities)	I1	I4	I5	I6	I7	NA
Basic resources (4)		1	2		1	
Industrial goods and services (2)		2				
Utilities (4)		2	2			
Energy (1)						1
Construction and materials (1)		1				
Telecommu-nications (2)				1	1	
Technology (1)					1	
Personal care, drugs, and grocery store (2)					1	1
Travel and leisure (1)		1				
Banks (1)						1
Totals (19)	0	7	4	1	4	3

The next section provides the conclusions and some final considerations from the analysis proposed.

4 CONCLUSIONS AND FINAL CONSIDERATIONS

Over the past years, several countries have seen the harmonisation or convergence of domestic standards to IFRS. This new panorama aims to improve the quality, reliability, and comparability of financial reporting amongst different countries.

However, despite the involvement of the IASB, regulators, and other stakeholders, it remains uncertain the level of effectiveness of the process of international harmonisation and convergence. In other words, it can be questioned whether IFRS accounting practices are consistently applied. The analysis proposed in this paper sought to materialize the professional judgment in terms of accounting practices adopted in Portugal, through possible evidence of different accounting treatments that can potentially mitigate the financial reporting comparability.

The analysis of the PSI 20 entities led to the conclusion that the practices adopted for the several cases assessed are not, in general, clearly defined in their accounting policies. Then, only after a careful reading of the notes, in some cases, it was possible to identify them, despite not clearly sometimes.

The practices identified are diverse, with different options regarding the income and expenses that can be affected by those events. Consequently, different impacts on the intermediate incomes can be verified from this information, depending on the option used.

Furthermore, it was not possible to consistently identify that the activity sector is an explanatory factor of the accounting practices chosen. This may be due, however, to the small number of entities assessed, which represents a limitation of this study.

Finally, it should be noted that some of the most observed practices are aligned with those recommended by the Portuguese standard-setter body. This may be an indication that this factor can influence the accounting practices defined by the entities that adopt IFRS in Portugal, as suggested by Nobes (2013).

Comparability is one of the objectives underlying the harmonisation process, conducted, and encouraged by the IASB, which is the qualitative characteristic that is behind this process. Nevertheless, there are still studies dedicated to identifying, in more specific terms, the different practices adopted in the financial report. Studies of such nature allow broadening the discussion around the implementation of measures to reduce the subjectivity associated with the adoption and application of IFRS, aiming to achieve higher levels of harmonisation or a *de facto* convergence.

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