The evolution of financial accounting in Portugal since the 1960s: A new institutional economics perspective

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Abstract

Using a new institutional economics perspective, this article analyses the economic and political context that led to accounting standardisation in Portugal from 1977 onwards and to the recent adoption of the International Financial Reporting Standards (IFRS). The process of accounting standardisation was related to the tax reform of 1963. Additionally, evidence was found that there were also political pressures related to the need to improve the national systems of accounts. The lack of development of the accounting profession and the emphasis on legality substantiated the need for enforcement in the law in 1977 of a standardised accounting plan that was similar to other plans in Europe, namely the French Plan. In a legalist country like Portugal, the modelling of national standards on the international ones and the definitive adoption of adapted IFRS in 2010 by unlisted companies had to be complemented by the enactment in law of the accounting regulations.

Keywords

Accounting standardisation, enforcement, IFRS adoption, new institutional economics, Portugal

1. Introduction

Portugal is a European country in the Latin tradition. The environmental factors that shape, reflect and reinforce the accounting systems have led international accounting academics, not surprisingly, to classify the Portuguese accounting system as belonging to the Continental European model (see for example, Gernon and Bindon, 1992; Nobes, 1989). As accounting systems are dynamic systems that define and reflect the institutional environment, and which also shape the environment, this classification is at the moment inaccurate. The initial pressures on accounting regulation that led to the adoption of the 1977 Accounting Plan form the starting point for analysing the advent of conventional models of financial reporting. The globalisation process and the consequent need for harmonised financial reporting have affected Portugal, which is reflected in the growing influence of the International Accounting Standards Board (IASB) in the global move to harmonise financial reporting internationally.

The present mandatory use of IASB standards (listed companies) and IASB standards adapted to Portugal (unlisted companies) is studied adopting a new institutional economics perspective (NIE).[1] This theoretical perspective is useful in conducting a study that treats accounting evolution in Portugal as a dynamic process of institutional change. Developed as an extension of the neoclassical economics framework, NIE abandons some of the simplified assumptions of neoclassical economics such as perfect information, individuals' perfect rationality, and zero transaction costs (Coase, 1937, 1960; North, 1990; Williamson, 1975). Questions on the nature of the state also troubled NIE's researchers such as North (1981).

In the last two decades NIE has moved forward, being exposed to interdisciplinary influences from the rest of the social and physical sciences. Ménard and Shirley (2011: 26) argued that "the three founding thinkers have led the way. They all have freely adopted from other fields: most notably, Coase from law, Williamson from managerial sciences and organizational theory, and North from political science, cognitive science, and history". The Northean branch of NIE is particularly useful in providing an understanding of the evolution of financial accounting in Portugal since the 1960s. Following this analytical framework, institutional analysis is combined with economic theory and economic history to understand the patterns of the development of financial accounting in Portugal (North, 1990, 2005).Thus, North's emphasis on learning and on the role of institutions as repositories of past learning is appropriate to conduct a study on accounting evolution in Portugal.

In a neoclassical economy with no transaction costs, institutions are irrelevant. But from an efficient perspective (see Williamson, 1975), institutions arise to reduce opportunistic behaviour and thus to reduce transaction costs, information costs and information asymmetry (Wysocki, 2011). Institutions are composed of the combination of formal rules (for example, laws and standards), informal rules (for example, customs, moral and social norms, and codes of conduct) and the enforcement characteristics of both (North, 1990). The combination of formal and informal rules defines the institution and provides the basis for continual incremental changes. Similar concepts have arisen in the sociology literature where institutions are defined as the "cognitive, normative and regulative structures and activities that provide stability and meaning to social behaviour" (Scott, 2001: 33).

As stated by North (1990), we believe that institutional change shapes the way society evolves and is the key to understanding historical change. North (1990: 53) refers to the idea of path dependence when he argues that "[h]istory matters. It matters not only because we can learn from the past but because the present and the future are connected to the past by the continuity of a society's institutions". Because of that, history is largely a story of institutional evolution (North, 1991). The belief systems ("the common cultural heritage" (North, 2005: 27)) are the underlying determinants of path dependence. The way the institutions evolve reflects the ongoing belief systems of the players (North, 1994).

Accounting as an institution can help to lower transaction costs and to reduce information costs and information asymmetry. Accounting helps facilitate more complex transactions in an economy. Like any institution, it should be understood as having to balance possible benefits from increased contracting efficiency against the costs of enforcement (Wysocki, 2011). Additionally, the quality of an accounting system is influenced by other institutions like the legal system, corporate governance mechanisms and the existence of laws governing investor protection and disclosure standards (Jeanjean and Stolowy, 2008). While literature on the impact of institutions on accounting is still in its infancy, there are various studies showing that when firms are subject to the same accounting standards, reporting practices differ considerably across firms and countries (Wysocki, 2011).

North (1990) states that if institutions are the rules of the game, organisations and their entrepreneurs are the players. Organisations include political bodies (for example, political parties, the Senate, regulatory bodies), economic bodies (for example, firms, trade unions) social bodies (for example, churches, athletic associations, *Sociedade Portuguesa de Contabilidade* – SPC, Portuguese Accounting Society),[2] and educational bodies (for example, schools, universities) (North, 1994). North (1990) contends that any theory about institutions must be based on human behaviours since all institutions are created and changed by humans. In this article we analyse how power, the interests of actors (the players of the game in society, the organisations) and the influence of historical, social and political factors were important: first in the accounting standardisation that occurred in 1977 and later in the process of adoption of IFRS by listed companies and IFRS as adapted for Portugal by the remaining companies. For this purpose, by using primary and secondary sources, we focus on institutions and organisations and on their role of institutional change (North, 1990).

North (1994) argues that the most fundamental long-term source of change is learning by individuals and the entrepreneurs of organisations. The speed of economic change is a function of the rate of learning. Institutions determine the choices that individuals make that shape the performance of societies and economies over time (North, 1993). Changes in the formal rules may come about as a result of legislative changes and of regulatory rule changes enacted by regulatory agencies. North (1993) contends that changes in informal constraints have the same originating sources of change as do changes in formal rules; but they occur gradually and sometimes quite subconsciously. The process of institutional change, namely the process of accounting change, is usually incremental but sometimes it can be a process of "revolutionary change". However, as North (1993) argues (and it will be seen in this article), "revolutionary change" is never as revolutionary as its rhetoric because the formal rules of accounting can change overnight but informal rules cannot. The direction of institutional change is determined by path dependence. Both the interests of the existing organisations and the mental models of the actors (the entrepreneurs) "rationalise" the existing institutional matrix and therefore bias the perception of the actors in favour of policies conceived to be in the interests of existing organisations (North, 1993: 38).

Recognising the interconnection of accounting with the state and the institutional context, we identify and analyse the standardisation of accounting in Portugal, since the 1960s. Accounting standardisation started to be claimed as necessary in March 1955 when Portugal, as a member of the OECD, began to publish national accounts on a regular basis using the 1953 OECD System of National Accounts. These claims intensified in the 1960s and 1970s. Following the tax reform of 1963, the requirement to standardise accounting information was increasingly experienced, in order to fulfil tax requirements. Accounting standardisation was regarded as important for the national system of accounts; and the tax reform of 1963 required that tax collection should be based on accounting numbers. As a consequence, an increased level of importance was assigned to accounting as an institution that can help reduce transaction costs. The absence of a comprehensive model that could offer guidance in preparing financial reports, to comply with tax regulations, launched a debate among professionals and academics of the time on the need, advantages, disadvantages and models to implement the standardisation of accounting. Despite the political constrains of those years, those debates led to the presentation of a few proposals for accounting plans to be implemented at a national level. The first official accounting plan was only adopted in 1977, after the Carnation Revolution.

In 2005, Portugal, as a member of the European Union (EU), adopted European Commission Regulation 1606/2002. In 2010, the existing code-law based Portuguese accounting system was replaced by the *Sistema de Normalização Contabilística* (Accounting Standardisation System) (hereafter *SNC*) that was inspired by standards issued by the IASB, to be used by unlisted companies.

This article contributes to the accounting history literature in several ways: first by unveiling primary and secondary sources related to financial reporting in Portugal since 1960; second, by interpreting the evolution of financial reporting using North's institutional framework. The neo-institutional economics perspective used in this article allows the formation of an understanding of the incremental changes that occurred when Portugal adopted the first official accounting plan; and the "revolutionary change" that happened in 2010, when the official accounting plan was revoked and replaced by *SNC*.

For the purpose of contributing to the understanding of the institutional dynamics that affected the standardisation and harmonisation of accounting in Portugal, the article is divided into five sections. Section 2 presents the institutional legacy of the 1960s in Portugal and the first Official Accounting Plan. The third section characterises the EU's drive to create common accounting standards and the adoption of the second Official Accounting Plan in 1989, developed to incorporate the provisions of the European Accounting Directives. Section 4 is devoted to the study of the growing influence of international standards on national accounting regulation: from the issuance of accounting standards that incorporated International Accounting Standards (IAS) provisions in the 1990s until the mandatory use of IASB standards on the consolidated accounts of listed companies in 2005, and the adaptation of IASB standards by unlisted companies (*SNC*) in 2010. Section 5 presents the conclusions of this article.

2. The institutional legacy of the 1960s

Pre-1974 proposals for a uniform Accounting Plan

Before 1977 there was no accounting regulation to offer guidance in preparing financial reports, it was the mercantile legislation which regulated, in a very general manner, the formal aspects of companies' accounting (Noel Monteiro, 1980; Tomé de Brito, 1964). The Portuguese Commercial Codes of 1833[3] and 1888 defined the books that merchants were required to keep and detailed broad bookkeeping requirements, such as the obligation of keeping a journal, a ledger and an inventory, which was written up within 90 days and retained for a period of 10 years (Ferreira, 1998: 803; Rodrigues et al., 2003: 105).

Between 1928 and 1974, Portugal was under a dictatorial regime that led the country to languish economically, politically and socially, remaining an "essentially small, agrarian country outside the mainstream" (Corkill, 1993: 1). In April 1974, a military revolution, the *Revolução dos Cravos*[4] (Carnation Revolution), overthrew the "totalitarian, police-run, corporative, anti-liberal, anti-democratic, anti-parliamentary, anti-collectivist, and disdainful of opponents" regime (Georgel, 1981: 302, quoted in Rodrigues et al., 2003: 108).

In 1928, Salazar was invited by the President of the Republic Carmona to solve the fiscal problems of the country. He accepted the position provided he could have veto power over all fiscal expenditures. He was appointed as Finance Minister in 1928 and was considered by his peers an authority on inflation (Baklanoff, 1992). Salazar was a "lecturer in accountancy" (Birmingham, 1993: 159) at the University of Coimbra, who "wrote articles on national bookkeeping for the press" (Birmingham, 1993: 157). In light of the fiscal chaos and the inflation of the previous period, Salazar considered the principles of a balanced budget and monetary stability as categorical imperatives. He dramatically changed the way fiscal policy was conducted: the dictatorial regime strictly observed the principle of fiscal balance. Public accounts began to show surplus immediately, putting an end to monetary problems arising from public account deficits (Marinheiro, 2005). Salazar's political and economic doctrines shaped the Portuguese destiny for forty years, first as Minister of Finance (1928–1932) and then as Prime Minister (1932–1968).

In Salazar's corporatist regime, both labour and capital should be subordinate to the central state apparatus. Under his dictatorial regime unions and associations were not free because there was censorship. This meant that there was surveillance and their interests had to be aligned with the state's interests. The statutes of these unions established that they would renounce any activity contrary to the state's interests and to class struggle. The corporatist regime established that it only could have one union per profession (each union had a monopoly). Members could elect the leader but the elected person had to be approved by the Secretary of State for Corporations. The unions depended on the Institute of Labour and Social Security to which they were accountable. Any magazine published by the union or association should be first analysed by the Secretary of State for Corporations. Strikes were prohibited by law since it was supposed that the state would solve any conflict that might arise (Patriarca, 1991).

Until the late 1950s, Portugal had a low per capita income, low worker productivity, a predominance of unskilled workers, a large fraction of the labour force in agriculture and comparative technological backwardness. Portugal's private sector was dominated by some forty great families allied by marriage. Bank officials were often members of the boards of directors of borrowing firms in whose stocks banks participated (Baklanoff, 1992). In this context agency problems were almost non-existent, therefore financial reporting was not important as a transaction cost reducer (Gwilliam et al., 2000). However, the rising influence of the Europe-oriented technocrats within Salazar's cabinet led to a Six-Year Plan for National Development (1959–1964) that had as its objective the acceleration of the country's rate of economic growth, a decision which was made more urgent as a result of the outbreak of guerrilla warfare in 1961 in several Portuguese colonies (Baklanoff, 1992).

Pressure for accounting standardisation commenced in March 1955 when a deputy at the National Assembly[5] asked for information on several issues including accounting standardisation.[6] These pressures intensified in the 1960s and 1970s (Carqueja, 1974; Ferreira, 1966; Noel Monteiro, 1980; Tomé de Brito, 1964). These early pressures established the need for a uniform system of accounting, and were related to the national accounting system and the taxation system. Both of these pressures should be understood in the context of the need to control public accounts and avoid fiscal deficits in a period of economic growth and war expenses. As a member of the OECD, Portugal began to publish national accounts on a regular basis using the 1953 OECD System of National Accounts. Accounting standardisation was important for national accounts as it would facilitate the integration of companies' accounts into the national accounts. The state and deputies are very important players of the institutionalisation game in society. Several arguments were used by the Corporative Assembly (30 June 1967: 56) in trying to create new formal rules:

> The collection of such data [related to the economic activity] involves substantial enhancements of the existing statistical system, including the system of national accounts, as previously pointed out, demanding special requirements also in the process of accountability for private entrepreneurs. In some larger industries, we should aim to standardise accounting quickly since accounting standardisation facilitates the integration of annual accounts in the national system of accounts.[7]

Additionally, the other important pressure was the tax reform of 1963 that approved the *Código de Contribuição Industrial* (Industrial Tax Code, ratified by the Decree-Law 45103, 1 June 1963).[8] The arguments used by the National Assembly (15 December, 1964: 4173) were:

> The implementation of the Code [Industrial Tax Code] requires ongoing attention by the tax administration. Hence I recommend the standardisation of accounting contemplating particularly the most significant taxable activities, thus ensuring tax justice through the assessment of accounting documents instead of using personal criteria.[9]

Accounting plays a role in the reduction of information costs and information asymmetry. At the time when the accounting profession was not regulated, the implementation of the Industrial Tax Code required the registration of accountants at *Direcção Geral das Contribuições e Impostos, Serviço de Prevenção e Fiscalização Tributária* (General Directorate of Taxation, Department of Prevention and Tax Inspection). The same deputy then confirmed that "with the new Code, the Department of Prevention and Tax Inspection was created, at the General Directorate of Taxation, where highly specialised accountants were registered".

While talking about the transition period of the new Code, a deputy contended (15 December, 1964: 4174) that:

> The transition period was imperfect. This was because Tax Administration accepted all accounting plans that were being used, without preparing beforehand a standardised accounting plan that could guide the taxpayer in determining the tax payable, or overcome the inertia, when it existed. [10]

This Code stated that the collection of tax should be based on accounting numbers, on the entity's profit that had to be calculated according to "sane accounting principles". Additionally, the Industrial Tax Code defined some bookkeeping requirements and accounting rules.[11] Due to its implications for government finances, taxation is extremely significant. Recognising the importance of accounting in the collection and management of taxation revenue, the Industrial Tax Code led to a significant increase in the importance assigned to accounting and to professional accounting skills,[12] raising the need to improve the quality of accounting by Portuguese companies, which had, at that time, total freedom in the organisation and preparation of their accounts (Carqueja, 1974; Ferreira, 1983–84; Noel Monteiro, 1980; Tomé de Brito, 1964). For that reason, it was not surprising to observe "the huge diversity in terminology, the misuse of certain expressions, and the variety of measurement criteria, and accounting procedures" (Ferreira, 1983–84: 543).

The tax-based model and commercial codes, using rigid uniform methods of accounting rather than general underlying principles date back to Colbert, Finance Minister to Louis XVI of France. The system was primarily designed to provide information to support public finance. It was a system widely followed throughout continental Europe and was not unique to the Salazar regime. This model linked Portugal to the accounting structures used in Belgium, Greece, France, Italy and Germany, among other nations (Avenel, 1995). Jorissen and Stabel (2010: 18) contend the regulation of accounting records was until 1975 "one of the most antiquated provisions of the Belgian Code of Commerce, of which its origin lay in the Colbert Ordinance".

In Portugal, as happened in Belgium:

> For the first 70 years of the 20th century companies had to value their assets, liabilities, costs and revenues according to the fiscal rules in order to determine their taxable income. Because accounting valuation rules did not exist and as companies wanted to avoid administrative work, the fiscal rules were used in the published annual accounts … De facto, these fiscal rules became the implicit accounting rules. (Jorissen and Stabel, 2010: 14)

As stated by Jorissen and Stabel (2010), this procedure did not harm the companies as the large majority of companies were financed by family owners and banks. As all parties were satisfied with the information they obtained there was not much need to develop accounting standards. The fact that the accounting profession in Portugal was not regulated until 1995 also helps in understanding the passivity of accountants and auditors.[13]

Proposals for a national accounting plan and related standardisation of accounting in Portugal can be traced back to the beginning of the 1960s. Tomé de Brito (1964: 270) considered that the Accounting Plan should be developed by academically qualified accountants, with experience and knowledge of the environment in which companies are immersed. Ferreira (1966), however, had a different view. While acknowledging that the standardisation of accounting should be heavily and widely discussed, the author considered that the task of regulating accounting had "national interest and implications", so it should be developed with the support of the Ministries of Justice, Finance, Economy and Education (Ferreira, 1966: 8).

The tax reform launched the debate about the need to standardise accounting information. The Portuguese accounting professionals were acquainted with international projects on the standardisation of accounting, and these were discussed by the *Sociedade Portuguesa de Contabilidade* (*SPC*, Portuguese Accounting Society)[14] which devoted several sessions to their study (Tomé de Brito, 1964: 283). Several articles were published in the Portuguese accounting journals (mainly in the *Revista de Contabilidade e Comércio* [Accounting and Commerce Review], by scholars, accountants, lawyers, economists) acknowledging the need to standardise accounting, evaluating its advantages, disadvantages and criticisms, reviewing the proposals of Accounting Plans made in other countries,[15] and debating the type of standardisation that should be developed.

The discussion on the advantages and disadvantages of adopting a national Accounting Plan followed the same lines as discussions overseas, gathering supporters and detractors of the project. The need for standardising accounting was generally acknowledged by all (Ferreira, 1970: 261), but how to standardise was contentious. As explained by Ferreira (1966: 299): "as evident as the need to proceed to accounting standardisation, [was] the difficulty, the impracticality of creating an unflawed standardisation scheme". According to Ferreira (1966: 8), most of the criticisms were of the process that should lead to standardisation and not of standardisation itself. Therefore, the creation of a rigid and very detailed Plan would provide more difficulties than advantages. A similar idea was pointed out by Gonçalves da Silva (1970), to whom accounting standardisation, if not too rigid and restrictive, and not only based on tax criteria, would have more advantages than inconveniences. This author stated that, while Portugal does not have an Accounting Plan,

> [t]he elaboration of a Plan that considers the interests of all companies, habits and convictions of all accountants is no more than a dream. But the failure to achieve the optimum is no reason to give up the good or to discard the reasonable. (Gonçalves da Silva, 1970: 345)

Between 1965 and 1974, four proposals for Accounting Plans were presented: two were prepared by the National Union of Professional Office Clerks (SNEEDL, 1965, 1970), one was presented by the Portuguese Accounting Society (*SPC*, 1974b, 1975), and another was submitted by the Tax Government Department of the Central Government (Ministério das Finanças, 1973). These four proposals failed to be adopted.

The first proposal, the *Plano Geral de Contabilidade: Projecto de Contribuição para o Plano Contabilístico Português* (General Accounting Plan: Contribution Project to the Portuguese Accounting Plan), was published in 1965. This study, developed by the Accounting and Statistical Commission of the Study Centre of the National Union of Professional Office Clerks of Lisbon (NUPOCL), presented a proposal for an Accounting Plan that followed the pronouncements of the Belgium, French, German, Swiss and International Accounting Plans (Carqueja, 1974, 1997). This proposed Plan was quickly discarded and, according to Carqueja (1974: 333), this was due to the eagerness of the accounting professionals who were concerned with the amendments promoted by the tax reform of 1963. In 1970, another working group of the NUPOCL presented a new proposal for an Accounting Plan, the *Plano de Contabilidade Nacional para a Empresa* (The National Accounting Plan for the Enterprise) that, according to its authors, should be considered as an appropriate solution for Public Administration, companies and professionals in achieving the standardisation of accounting at a national level (Batista da Costa and Alves, 2001: 70). This proposal did not follow the more well-known Accounting Plans once it was believed that they were outdated relative to companies' needs (Castel-Branco, 1970; Noel Monteiro, 1970). Noel Monteiro (1970: 324) contended that the authors of this second Plan were "searching for originality", due to the unusual terminology that was used, and which would mean that the second Plan could not be easily adopted. A novelty of this second proposal was the inclusion of a budget model for companies (Batista da Costa and Alves, 2001; Noel Monteiro, 1970).

A third study on accounting standardisation, the *Anteprojecto de Plano Geral de Contabilidade* (Draft of the General Accounting Plan),[16] was developed between 1970 and 1973. This time not by a professional national union but by a three-member Commission of the Tax Government Department of the Portuguese Central Government, trusted with the job of elaborating a broad-spectrum accounting plan (Ferreira, 1970). Based on the French Accounting Plan, this Draft was a proposal to modernise accounting and was intended to allow greater fairness in income taxation (Ferreira, 1998: 805). The appropriateness of the French Plan, as a role model to follow, was acknowledged by one of its authors, Rogério Fernandes Ferreira (Ferreira, 1965, 1966, 1971, 1972). Ferreira (1972) argued the French Plan to be the most complete work of its kind, the most popular used by Portuguese accountants, and a proper model comprising definitions, concepts, rules of movements in accounts and measurement criteria. Like the French Plan, this Draft Plan proposed a dual accounting system, considering financial and cost accounting to be independent. Additionally, the proposed decimalised codified chart of accounts was also similar to the one in the French Plan[17] (Ministério das Finanças, 1973).

The Government took the lead in the standardisation process, which although advantageous due to "the conformism and lack of initiative from most of the professionals", would subordinate accounting to taxation (Carqueja, 1974: 335). Comprising a chart of accounts ordered by classes, models for classifying the balance sheet and the income statement by nature, and notes, the Draft Plan was published in 1970 and was presented as the basis for a discussion on whether the Plan should be adopted nationally. A call to all those who were interested in accounting, to comment on and criticise the Project was made by its authors and also by several academics who wished to see the subject thoroughly and publicly discussed (see for example, Castel-Branco, 1970; Gonçalves da Silva, 1970).

The Draft of the General Accounting Plan attracted several criticisms, mostly due to its rigidity and high level of detail in the codification of the accounts that put companies' structures and the professional judgement of accountants into a "straitjacket" (Dória and Dória, 1975; Noel Monteiro, 1970; Pimenta, 1971). Furthermore, it was considered that the leading of the standardisation process by the Tax Department of the Government (and the consequent submission of accounting to taxation rules) was inappropriate (see for example, Castel-Branco, 1970; Dória and Dória, 1975; Pimenta, 1971). While appreciated and used by several accountants (Noel Monteiro, 1966), the role model of the French Plan was considered inappropriate by some scholars, who highlighted the criticisms made abroad of the Plan and acknowledged that the adoption of an accounting plan in Portugal should attend to the needs of the Portuguese economic system (see for example, Castel-Branco, 1970; Lopes Amorim, 1971; Noel Monteiro, 1970; Pimenta, 1971; Pinho, 1971). The disadvantages of accounting standardisation for the development of accounting as a science were also identified by Lopes Amorim (1971), Noel Monteiro (1970) and Pimenta (1971). Nevertheless, the Tax Government Department was quite sure of the validity of this Draft Plan and, in 1973, a "recommendation for general adoption" was enacted (Faveiro, 1973). The intention of the Government was to adopt the Accounting Plan from 1974 (Faveiro, 1973). However, the military coup in April 1974 caused this attempt at adopting a uniform national plan to fail.

The last project, entitled *Plano Português de Contabilidade* (Portuguese Accounting Plan), was presented in 1974 by another entrepreneur, the *SPC*. It comprised only a chart Plan of Accounts (SPC, 1974b, 1975). While developing its own Plan proposal, the *SPC* promoted a debate about the draft Plan issued by the Tax Government Department, which raised several of the criticisms previously mentioned (SPC, 1974a). In September 1973, the *SPC* issued a paper with the results of that debate, providing criticisms and suggestions on the Government Draft Plan that were published in the Bulletin of the *SPC* (SPC, 1974a: 17–19) and presented to the Government.

Within a scenario characterised by the lack of organisation of the accounting profession, and by the lack of coordination among scholars and academics – which only together could exert some positive influence on the standardisation process (Carqueja, 1974: 332) – none of the described proposals for an Accounting Plan were successful. Acknowledging the legislative character of the Portuguese accounting system, the most influential standardisation initiative, prior to the appointment of the Portuguese Accounting Standards Board (*Comissão de Normalização Contabilística*, hereafter *CNC*) in 1975, was the one developed by the Tax Department. This proposal was not adopted due to the Carnation Revolution and the consequent change of the Portuguese regime from an authoritarian dictatorship to a liberal democracy.

North (1993) contends that the degree to which there is a commonality between the objectives of the institutional constraints and the choices individuals make in a particular setting depends on the effectiveness of enforcement. As all parties were satisfied with the information they obtained, enforcement of the accounting plan by the state was necessary. Mantzavinos et al. (2004) also argue that in the case when the content of the shared learning is the same or similar over a number of periods, people become relatively inflexible. The more inflexible the mental models are, the more difficult their modification and revision become. Because of that, the standardisation of accounting would need to be enforced. Additionally, cooperation is difficult to sustain when there are a large number of players – working groups of the national union NUPOCL, state and *SPC* (North, 1991).

The Official Accounting Plan of 1977

The "Carnation Revolution" was more than a military revolution; it was also a political and social revolution that profoundly changed Portugal's political and economic systems (Barreto, 1992). Broad democratic liberties were immediately granted and opposition political parties were legalised, while the corporate state apparatus was gradually dismantled (Barreto, 2000; Marques and Serrão, 1991; Mattoso, 1994; Reis, 1989). In the following years, as moderate socialist or moderate social democrat governments became democratically elected, there was a gradual transition to more liberal economic policies (Linz and Stepan, 1996).

After the Carnation Revolution, economic reconstruction was given priority and the Economic and Social Program of the Government stated that the adoption of a standardised Accounting Plan by companies would be an important measure to avoid tax evasion and to provide tax fairness (OECD, 1974). Within the paraphernalia of political, economic, social and cultural changes that were taking place in Portugal, accounting standardisation began to be put in place to reduce uncertainty. As ascertained by North (1991: 97): "throughout history, institutions have been devised to create order and reduce uncertainty in exchange. Together with the standards of economics they define the choice set … Institutions provide the incentive structure of an economy".

Filling the void of a uniform system of accounting, on 7 February 1977 an Accounting Plan – the *Plano Oficial de Contabilidade* (*POC*) – was approved and the *CNC* was ratified (Decree-Law 44/77). In November 1974, following the Government Program, a state Commission of 16 members – the Portuguese Accounting Standards Board (*CNC*) – was appointed with the aim of studying the standardisation of Portuguese accounting in the post-dictatorship era. The Commission, representing the interests of Government, education, science, professional organisations, companies and unions, was enforced by law in February 1975 (Ministerial Dispatch of 27 February, published in the Government Journal No. 65, II Series, 18 March 1975). The law enacting the *CNC* highlighted the "long-lasting need for a standardised accounting plan" that would allow the "consistent analysis and comparison of the financial position and annual income of companies" (Ministerial Dispatch of 27 February 1975) and reduce transaction costs. The document also stressed that, in addition to the standardisation of the concepts and the chart of accounts, the adoption of "sane accounting criteria" was mandatory, in order to provide transparency and reliability to the financial data disclosed by companies, essential for a "broad and confident analysis" (Ministerial Dispatch of 27 February, 1975). Furthermore, the standardisation of accounting would offer "numerous advantages" to tax authorities, "making more efficient and less controversial its task" (Ministerial Dispatch of 27 February 1975). While being a technically independent body, the *CNC* is, and has been since its initial days, administratively and financially under the scope of the Ministry of Finance. Portugal did not have a developed accounting profession in the mid to late 1970s, and under the Continental European influence/tradition it was not regarded as intrusive for the state to regulate the accounting affairs of enterprises, which then would be enforced by the law.

It was August 1975 when the *CNC* released a draft entitled "Accounting standardisation – 1st Phase" (CNC, 1975). This draft of the Plan was the subject of public discussion until November 1975 and comprised several sections that defined financial statement models (analytical and synthetic balance; income statement by nature; broad and specific comments pertaining to the balance sheet and income statement; notes to the accounts), proposed a chart of accounts, and prescribed some measurement criteria. This document also stressed that to prepare this Plan, the Commission analysed the use of Uniform Accounting Plans and the degree of interventionism of the Public Administration in accounting standardisation in several countries,[18] and the works developed attempting to elaborate international Plans by the *Union Européenne des Experts Comptables, Economiques et Financiers*, by the International Co-ordination Committee for the Accounting Profession, and by the *Groupe d'Études des Experts Comptables de Ia CEE* (CNC, 1975). In this Draft Plan, the *CNC* also stated that it had decided to present a study that did not take advantage of the previous proposals of an Accounting Plan already made in Portugal (CNC, 1975).

As stated by Ferreira (1976: 246), the work developed by the *CNC* during this first stage fell short of what was expected, resulting in "a very incomplete Plan". Moreover, comparing the two drafts of Accounting Plans (the third draft developed by the Government and the *CNC* draft), Ferreira (1976, 1977, 1983–84) asserted that the changes were not structural, and similarities within the two projects were not highlighted,[19] which would have helped and appeased managers and technicians who had been using the Draft Plan of 1970–1973, or similar models.

Following the presentation of the "Accounting standardisation – 1st Phase" (CNC, 1975), the *CNC* elaborated the income statement by functions (comprising five interconnected maps) and the chart list of the codified accounts, and defined and annotated most of the accounts and their relations and connections with the financial statements. Subsequently, the *CNC* revised the Draft, considering the criticisms and suggestions received. At the end of 1976, the work of the *CNC* was submitted to the Government, leading to the adoption of the first Portuguese Accounting Plan, the 1977 Official Accounting Plan (*POC/77*), which was approved by Decree-Law 44/77 on 7 February

1977. Regulating the provision and publication of the individual financial statements of the national public and private companies,[20] the Plan followed what "was becoming usual in other European countries", which would facilitate the connection of the Portuguese model with broader accounting standards (POC, 1977, §7).

The *POC/77* promoted a compliance model of accounting rather than one based on professional judgement under a principles-based approach to accounting (as happened with the previous attempts to promote accounting standardisation). The Plan was limited in relation to measurement criteria and accounting principles; it only listed those that should be adopted: going concern; consistency; effectiveness of the operations; historical cost; recovery of the cost of inventories; and conservatism. Without a clear definition of accounting principles, measurement criteria and accounting concepts, the *POC/77* stipulated that support for these topics should be found in Schools and Faculties where accounting was taught. Improvement of the measurement criteria and the development of management accounting[21] would be left for a future phase of the standardisation process (POC, 1977, chapter 1, § 9–10).

The *POC/77* was a means of regulating the provision of accounting information that prior to 1977 did not have a uniform approach to income determination. While its benefits were to accrue in the context of financial change, by a wide range of users,[22] it was a measurement system concerned with the uniform measurement of income, primarily to facilitate the operation of a national taxation system for companies (Carqueja, 1997; Ferreira, 1998; Ferreira et al., 2007). According to Noel Monteiro (1980: 184), accounting in Portugal had been organised according to tax criteria, promoting a "tax mentality" among accountants, who even started to "consider accounting rules, including those that were no more than tax rules". Since *POC/77* did not establish the accounting rules to be used, for example, to calculate amortisation, depreciation and provisions, tax criteria were used by accountants. This helped to maintain the confusion between tax criteria and accounting rules. As happened in France, in the absence of detailed definitions in *POC*, "the fiscal authorities have supplied definitions to tighten accounting for tax purposes, with the effect that accounting measures have been importantly influenced by taxation" (Bocqueraz, 2010: 50). The same thing happened in Spain, as acknowledged by Lainez (1994: 49):

> Therefore, by virtue of the absence of alternative and obligatory accounting principles as applicable to companies, the fiscal standards constituted the basis for the preparation of financial information in Spain for many years, especially with respect to small and medium-sized companies.

As already described, there were four earlier attempts to adopt a uniform national accounting plan, but any proposal that did not have governmental support would not be implemented. For that reason, it is not surprising that the Accounting Plan was published in the form of the decree-law that enforced the *POC/77*. In the new social and economic period, the creation of a sole entrepreneur supported by the Minister of Finance (the *CNC*), and the later enforcement of the Accounting Plan by decree-law were the most important reasons for the successful implementation of this formal rule.

3. The EU's drive to create common accounting standards

The adoption of the 1989 Official Accounting Plan

POC/77 was in effect until 31 December 1989, but on 1 January 1990 a new Accounting Plan came into force. During the 13 years of the application of *POC/77* several laws amending it were approved and 12 Interpretative Standards (Normas Interpretativas) were issued by the CNC. The revision of *POC/77*, after such a short life, was a consequence of Portugal's entry into the European Economic Community (EEC) in 1986, with the accession negotiations having commenced 10 years earlier.

In the aftermath of the Carnation Revolution, the assumptions underlying Portuguese foreign policy radically changed. The establishment of democracy and the decolonisation process that reduced Portuguese interests in Africa replaced the African focus of Portugal's international policy with a European one[23] (Lopes, 1985; Soares, 1976). Likewise, the effects of the economic crisis of the early 1970s and the EEC enlargement towards the south of Europe could not be ignored (mapped clearly with the application of Greece to join the Community in 1975). The Program of the first Portuguese Constitutional Government, presented in August 1976, highlighted that Portugal could not overlook the growing significance of the European market, and that entry into and participation in European political, economic and social institutions were crucial (Avilez, 1996; Soares, 1976).

Portugal joined the Council of Europe on 22 September 1976 and officially submitted its application for accession to the EEC on 28 March 1977 (EEC, 1977). Grounded in political and economic motivations (Soares, 1977), admission to the EEC was considered fundamental "for the consolidation of the fledgling pluralist democracy and as a bulwark against a return to dictatorship" (Corkill, 1993: 88). The laborious negotiations culminated in the signing of the Accession Treaty, in Lisbon, on 12 June 1985, which came into force on 1 January 1986.

The way accounting standardisation evolves reflects the ongoing belief systems of the players (North, 1994). As a full member of the European Community (EC), Portugal became bound by "European accounting directives, common education and training requirements, compulsory mutual recognition of qualifications and more" (Harding, 2000: 593). Consequently, the EU Company Law Directives had to be integrated into the Portuguese regulations, which promoted the reform of the Commercial Code, the Companies Law and the Accounting Plan. Additionally, a major reform of the Taxation Laws led, in 1989, to the approval of new Codes covering personal income tax and profit-based taxes for business entities (*Código do Imposto sobre o Rendimento das Pessoas Singulares* and *Código do Imposto sobre o Rendimento de Pessoas Colectivas*). These were prompted, in part, by Portugal's entry into the EU. The new tax codes were a response to the new competitive demands of the European single market and the urgent need to rein in public deficits (Rodrigues et al., 2003). This led the Portuguese Government to negotiate with the accounting profession as part of its flirtation or dalliance with corporatism. The Government recognised the importance of a professional cadre of state-licensed registered accountants to assist in achieving economic and monetary union objectives. As Puxty et al. (1987: 284) have pointed out, a corporatist state:

> … does not simply license the existence of organised interest groups but incorporates them into its own centralised hierarchical system of regulation. In doing so, the state simultaneously recognises its dependence upon these associations and seeks to use them as an instrument in the pursuit and legitimation of its policies.

In 1995 the Statutes of Registered Accountants were issued. The statutes established the *Associação dos Técnicos Oficiais de Contas* (ATOC) (Association of Registered Accountants) and the accounting profession was finally regulated (Rodrigues et al., 2003).[24] In Portugal, the state controls the degree to which accountants are permitted monopolistic access to certain forms of work (Chua and Poullaos, 2002). This was considered important, since as argued by Abbot (1988) professions do not operate independently but are always in competition with one another, as they wish to control valuable jurisdictions that are both tangible, in the case of state-controlled professional boundaries (as is the case now in Portugal), and also abstract, in the case of cognitive skills.

In the accounting field, the adoption of the EEC's Fourth Directive, led to the revision of the Official Accounting Plan, approved by the Decree-Law No. 410/89 on 21 November, 1989, and known as *POC/89*. With a similar structure to *POC/77*, this new Plan comprised the following 12 chapters: (1) Introduction; (2) Technical considerations; (3) Characteristics of financial information; (4) Accounting principles; (5) Measurement criteria; (6) Balance sheet; (7) Income statement; (8) Notes to the balance sheet and income statement; (9) Statement of source and application of funds;[25] (10) Chart of accounts; (11) Accounts codification; and (12) Explanations of the content and movement of accounts. To adopt EEC's Seventh Directive, *POC/89* was amended in July 1991 (Decree-Law No. 238/91), incorporating two additional chapters: (13) Accounts consolidation rules; and (14) Consolidated financial statements.

Portugal was part of a wider institutional European environment, with which it was required to interact. The Directives were the legal instruments initially chosen by the European Commission to promote the harmonisation of accounting, as part of its programme of company law harmonisation that was undertaken after the Treaty of Rome. The Fourth Directive, related to the accounts of limited companies, was approved on 25 July 1978, providing requirements relating to measurement criteria, formats of published financial statements and disclosure requirements (EEC, 1978). It was followed by the Seventh Directive of 13 June 1983 that extended the principles of the Fourth Directive to the preparation of consolidated accounts (EEC, 1983). Due to different European traditions of accounting and information disclosure policies, the Directives were the result of long and difficult negotiations. Accounting Directives compromise the Continental and Anglo-Saxon accounting systems, "with perhaps more emphasis placed on disclosing the nature and effect of differences between countries than on removing them" (Radebaugh et al., 2006: 161). The intention of the Directives was not to produce uniformity but rather to bring about harmonisation of the existing legal requirements (Nobes, 2008; Radebaugh et al., 2006; Thorell and Whittington, 1994).

As stated by Nobes (2008: 85), "the exact effects of any Directive on a particular country will depend upon the laws passed by national legislatures". The adoption of the Fourth Directive, in Portugal, did not promote major changes to the ongoing accounting regulations (Ferreira and Regojo, 1996; Gonçalves da Silva et al., 2008). The *CNC* chose to adopt the provisions of the Directive that promoted less amendments to *POC/77* as a way of facilitating the work of accountants and users of financial statements (POC/89, §1.4).

POC/89 is technically more developed than *POC/77* (Batista da Costa and Alves, 2001; Gonçalves da Silva et al., 2008), devoting individualized sections to some of the elements of the Conceptual Framework, such as the qualitative characteristics of financial reporting, accounting principles and measurement criteria (POC/89, chapters 3–5). A change of emphasis in the Portuguese accounts was brought about with the introduction of the overriding principle of the "true and fair view", requiring the disclosure of additional, or in exceptional circumstances different, information from that required specifically by the *POC/89*. As in the rest of the European countries, the incorporation of this Directive in national requirements included substantial flexibility and allowed for alternative measurement approaches such as current replacement cost, revaluations and price-level adjustments. A sharp effect was also felt in the disclosure requirements, which were developed to only a limited extent in *POC/77*. The considerable augmentation of notes to the accounts raised the level of information disclosure and transparency. Another major development in Portuguese accounting regulation was promoted with the adoption, in 1991, of the Seventh Directive that made the presentation of consolidated financial statements compulsory and defined the methods for their preparation for all groups controlled by a parent company. While the UK and Ireland, for example, had extensive legal regulations for consolidated financial statements, Portugal had no provisions on this matter. Group accounts, neglected prior to the adoption of this Directive, became regulated by Chapters 13 and 14 of *POC/89* that substantially enhanced the extent of information disclosure.

During this stage of the Portuguese accounting harmonisation process, the pressures to revise the existing Plan came, indirectly, from the EC and more directly from the Government that had to integrate into the national law the Fourth and Seventh Directives. As a full member of the European Community, Portugal had to adopt "the rules of the game" (Mouck, 2004); it needed to be seen as a modern nation and a legitimate recipient of the benefits in belonging to the EU. While acknowledging that the aim of accounting had shifted towards providing useful information for the business community[26] (POC/89, chapter 3), accounting information was still mainly devoted to fulfilling the needs of tax authorities and creditors.

The influence of IASB standards in national accounting standards

The Directives were not able to promote an acceptable level of comparability and equivalence between European financial statements (CEC, 1995; Hopwood, 1990; Van Hulle, 1993). The Directives were a noteworthy starting point in the harmonisation process but, at the beginning of the 1990s, it had become clear that the Directives were "too cumbersome and slow to achieve further useful harmonisation" (Alexander et al., 2007: 47). However, as argued by Aisbitt (2008), the EU has apparently drawn on the experience of implementing these directives with its new model for regulating accounting change introduced with the IAS Regulation of 2002.

While the shift of the European harmonisation process was taking course, Portugal, as mentioned, had just amended the accounting regulations to comply with the Directives. At the time of its adoption, the *POC/89* was already outdated; the Fourth and Seventh Directives had, respectively, 11 and six years of existence. Additionally, having being approved by a decree-law, making amendments to cover new developments or to reduce the range of accounting options was very difficult.

Within this scenario, in 1991 the *CNC* started issuing Accounting Standards – the *Directrizes Contabilísticas (DCs)* – to complete, clarify and update the *POC/89*. Between 1991 and 2005 the *CNC* issued 29 *DCs*. Most of the *DCs* are no more than an abbreviated translation of the related IAS. Most of them were proposed by members of the *CNC* or by the Ministry of Finance, only a modest number of *DCs* resulted directly from the influence of companies (Ferreira and Regojo, 1996). Nevertheless, the legality and mandatory effect of the *DCs* was heavily questioned, since they were not approved by a decree-law as the *POC* had been. An attempt to solve this issue was made in 1998 with the approval of the *DC No. 18* "Objectives of the financial statements and generally accepted accounting principles", which stated that the use of GAAP should be subordinated to the following hierarchy: *POC; DCs*; and IASB standards in the event of the absence of Portuguese accounting rules (DC 18, §4). However, this *DC* did not solve the lack of legality. Only in the following year, with the approval of the Decree-Law No. 367/99, did *DCs* become mandatory.

The languishing of the European Directives in respect to accounting regulation provided the basis for continual incremental change and led the *CNC* to develop standards in line with IASB standards (North, 1990). The accounting regulation approach followed by the *CNC* resulted in the Portuguese accounting system beginning to lose its Continental influence and become closer to the IASB's model (Fontes et al., 2005; Jarne, 1997).

4. The adoption of IFRS standards and the adaptation of IASB standards for unlisted Portuguese companies

While several countries and some stock exchanges changed their laws to allow the use of non-domestic standards (Van Hulle, 2004), in Portugal that sort of measure was not adopted. The

IASB's influence on Portuguese accounting was not felt through the direct use of its standards, but through its inclusion on *DCs*.[27]

Although the issuing of the *DCs* was intended to keep the Portuguese accounting system in line with international accounting trends, a lot of disparities between national and international accounting standards – in the depth and complexity with which several accounting subjects were handled – persisted at the beginning of the new millennium.[28] Consequently, substantial preparation was necessary for Portuguese listed companies to get ready to comply with IFRS in 2005, in consolidated accounts as required by the IAS EU Regulation (2002). Regulations are the most direct form of EU law, they have binding legal force throughout every Member State, on a par with national laws. The Portuguese government does not have to take action themselves to implement EU regulations.

In the middle of 2003, the level of preparedness of Portuguese listed companies to implement IFRS was relatively low. Larger companies with higher levels of commercial internationalisation, and audited by the Big 4 international accounting firms, were the ones that presented the higher levels of preparedness (Guerreiro et al., 2008). With the mandatory adoption of IFRS in mind, in January 2003 the *CNC* issued a document entitled "Proposed Guidelines for a New Model of Accounting Standardisation" (*Projecto de Linhas de Orientação para um Novo Modelo de Normalização Contabilística*). Recognising the limitations of the national standardisation accounting model[29] and the significance of the international harmonisation movement, the *CNC* presented a proposal for a comprehensive model of accounting for all Portuguese companies that should follow IASB standards, while taking into account the features of the national economy (CNC, 2003, §41, 42). Therefore, the *CNC* proposed a dual standard model (in line with the EU regulation) that follows the IASB Conceptual Framework and comprises two levels of regulation (CNC, 2003, §49). The first level includes the companies that have to follow IAS Regulation (listed companies), while the second level includes the remaining companies which would adopt IFRS that were adapted to Portugal. This second level of accounting standardisation comprises the following elements: IASB Conceptual Framework; accounting standards and interpretations adapted from IFRS to entities with less information needs; layout model for financial statements for annual and consolidated accounts; and a chart of accounts[30] (CNC, 2003, §50–59).

The *CNC*, following the option included in articles n.º 4 and 5 of the EU Regulation (2002), allowed the extension of IAS Regulation to unlisted and individual accounts (Decree-Law No. 35/2005, art. 12, February, 17, 2005). IFRS were permitted for use by listed companies in their individual accounts; and IFRS were also permitted for use by unlisted companies in their consolidated accounts and in their individual accounts. However, the voluntary adoption of IFRS for the individual accounts of listed and unlisted companies was subject to two conditions: first, companies must maintain another accounting system for individual accounts that accorded with the national accounting system; and second, companies must have had their accounts audited. From 2005 until 2010 some listed companies adopted a dual accounting system: they were required to keep the Portuguese GAAP accounting system and they voluntarily adopted IFRS in individual accounts. The requirement to keep the Portuguese Accounting Plan in the individual accounts is related to the need to use it for taxation purposes.

Following the Proposed Guidelines for a New Model of Accounting Standardisation (CNC, 2003), the *CNC* developed the elements that would incorporate the second level of the accounting standardisation model. This set of elements was named *Sistema de Normalização Contabilística – SNC* (Accounting Standardisation System) – and was disclosed on the *CNC* website after its approval by the General Council of the *CNC* on 3 July 2007. In 2008, the Minister of Finance emphasized the advantages of the *SNC*. He noted that the *SNC* model "will be an additional vehicle to modernize our economy because our companies and economic agents will be better able to integrate into the new economic world context" (Teixeira dos Santos, 2008: 2). The Secretary of State for Fiscal Affairs (Lobo, 2008: 5) reinforced this by asserting the capacity of the new accounting rules to reduce transaction costs between national and international companies: "the new accounting strategy is appropriate in the actual context of internationalisation … the *SNC* is itself a source of competitiveness…".

The *SNC* closely follows the *CNC* proposal (CNC, 2003) and includes the elements previously defined. Additionally, considering the different forms of complexity and levels of disclosure requirements for small entities, a Financial Reporting Accounting Standard for those entities was also defined (NCRF-PE). It was the *CNC's* intention that the *SNC* would be applicable by 2008. That did not happen, and it was only on 13 July 2009, with the approval of Decree-Law No. 158/2009, that it was stated that the *SNC* was going to be mandatory from 1 January 2010 onwards, replacing the *POC/89* and the *DCs* (CNC, 2009). Only when the Companies' Income Tax Code was revised to permit companies to be taxed using IFRS (Decree-Law No.159/2009), that the *SNC* came into force and listed companies could use only IFRS in the preparation of individual accounts. The revision of the Companies' Income Tax Code had as an objective adapting the tax criteria used to calculate taxable profit to IFRS. It was established that if no different tax criteria existed, the accounting rules should be used to determine taxable profit.[31] There was an effort to follow as far as possible the IFRS criteria in calculating taxable profit. As IFRS provide accounting rules for each accounting transaction, accountants are now required to use accounting rules when preparing financial information. A definitive separation between accounting and taxation is expected, and accountants now have to adopt tax criteria but, also, have to perform a few (different) accounting entries for financial reporting.

The solution proposed by the entrepreneur *CNC* can be considered as a "revolutionary change" (North, 1993: 38), when compared to the solutions achieved by countries that have had similar accounting standardisation processes. In Portugal the Portuguese accounting plan was revoked, new and sophisticated accounting standards, similar to IFRS, were issued. The use of IFRS for individual accounts is still forbidden in Belgium. The link between accounting and taxation inhibits a change in the law on this issue. While Belgium did not adapt the Accounting Plan to IFRS (Jorissen and Stabel, 2010), France's convergence of the *Plan General Comptable* was achieved in several areas (for example, consolidation), although convergence is being constrained for taxation reasons (Bocqueraz, 2010: 53). The incremental change that was observed in France, can also be found in Spain:

> against the purists' voices who demanded the direct translation of IAS for the Spanish regulation, the national legislature body decided, rightly in our opinion, to keep the *Plan General de Contabilidad* (PGC90), in order to facilitate the learning and the use of the new accounting criteria. (Molina Llopis, 2007: 114)

In these countries, the entrepreneurs assessed "the gains to be derived from recontracting within the existing institutional framework compared to the gains from devoting resources to altering that framework" (North, 1990: 37). Therefore, it is the perceptions of the entrepreneur (correct or incorrect) that justify the actions. The subjective perceptions (mental models) of entrepreneurs determine the choices they make. In the case of incremental change (convergence of accounting plans that already exist), the network externalities that arise from a given institutional matrix of formal rules, informal constraints, and enforcement characteristics biased costs and benefits in favour of choices consistent with the existing framework (that is, the accounting plans produced path dependence). The larger the number of rule changes, *ceteris paribus*, the greater the number of losers and hence opposition; in this case institutional change occurred at those margins considered most pliable in the context of the bargaining power of interested parties (North, 1993).

The sources of change are the opportunities perceived by entrepreneurs. They stem from either external changes in the environment (the globalisation of accounting) or the acquisition of learning and skills and their incorporation in the mental constructs of the actors (most of the *CNC* members are auditors who had at the time IFRS knowledge). The acquisition of learning and skills led to the construction of new mental models by entrepreneurs. North (1993) contends that it is usually some mixture of external change and internal learning that leads to institutional change. A "revolutionary change" occurs as a result of gridlock arising from a lack of mediating institutions that enable conflicting parties to reach compromises. In the case of the *CNC* it had limited degrees of freedom to bargain and still maintain the loyalty of its members (most of the *CNC* members wanted a radical change).[32] Therefore, the *POC/89* was revoked and replaced by a completely new set of accounting standards.

However, as emphasised by North (1993), "revolutionary change" is never as revolutionary as its rhetoric would have us believe. While formal rules changed overnight (*SNC* was adopted on 1 January 2010), informal constraints did not. Inconsistency between the formal rules and the informal constraints (which are the result of deep-seated code-law accounting cultural inheritance) results in loose coupling: although Portugal is adopting IFRS standards (listed companies) and adapted IFRS standards (unlisted companies), there is a feeling that the new chart of accounts was the only thing that was learned by most of the accountants who work with SMEs. It will take time until professional judgement and the accounting standards can be completely assimilated by the accounting professionals; it will also take time to change from a code-law institutional logic to a common-law institutional logic. Therefore, the present new equilibrium is far less revolutionary than the rhetoric. Following an accounting model based on principles, which follows the IASB's model, the disparities with existing rules defined in *POC/89* and *DCs* are substantial, presenting a complete change of philosophy that puts increased responsibility on accountants' judgement (Correia, 2009).

There have been two important developments in Portuguese accounting regulation concerning SMEs. The first was the change of the limits under which companies were allowed to use the NCRF-PE. Law No. 20, of 23 August 2010, allowed many more companies to use the NCRF-PE (companies under two of the three limits: total assets of €1,500,000; total sales and other income of €3,000,000; and a total number of employees of 50). The proposal was prompted by complaints about the difficulties SMEs were having in preparing to adopt the IFRS adapted to Portugal (*SNC*). The second major development was the creation of an additional level of accounting regulation for micro-entities.[33] Accordingly, on 2 September 2010 the Portuguese government issued Law No.35, to relieve micro companies of the obligation to adopt the NCRF-PE if they are under two of the following three limits: total assets of €500,000; total sales and other incomes of €500,000; and a total number of employees of five. These companies adopt a specific regulation for micro-entities that establishes basic and simple recognition, measurement and disclosure requirements; a code of accounts and simplified financial statements. They disclose very simple versions of the balance sheet, the income statement and the notes. Additionally, Decree-Law No. 36-A/2011 established the accounting regime for non-profit entities, which is an adaptation of the *SNC* to these entities.

Since the regulation of the accounting profession in 1995, the collaborative relationship the profession has with the Portuguese Government enabled the negotiation of some concessions during the establishment of the *SNC* ("profession-state dynamics"; Chua and Poullaos, 2002: 438). Because the adoption of a new accounting system imposed so many challenges on the accounting profession, it was necessary to provide professional training. As part of a bargaining strategy, the state compensated the profession by raising its social status from "Chamber" to "Order",[34] and the "Order" became the only recognised representative of the accounting profession in the *CNC* (contrary to the old structure that recognised several other associations of accountants). However, as

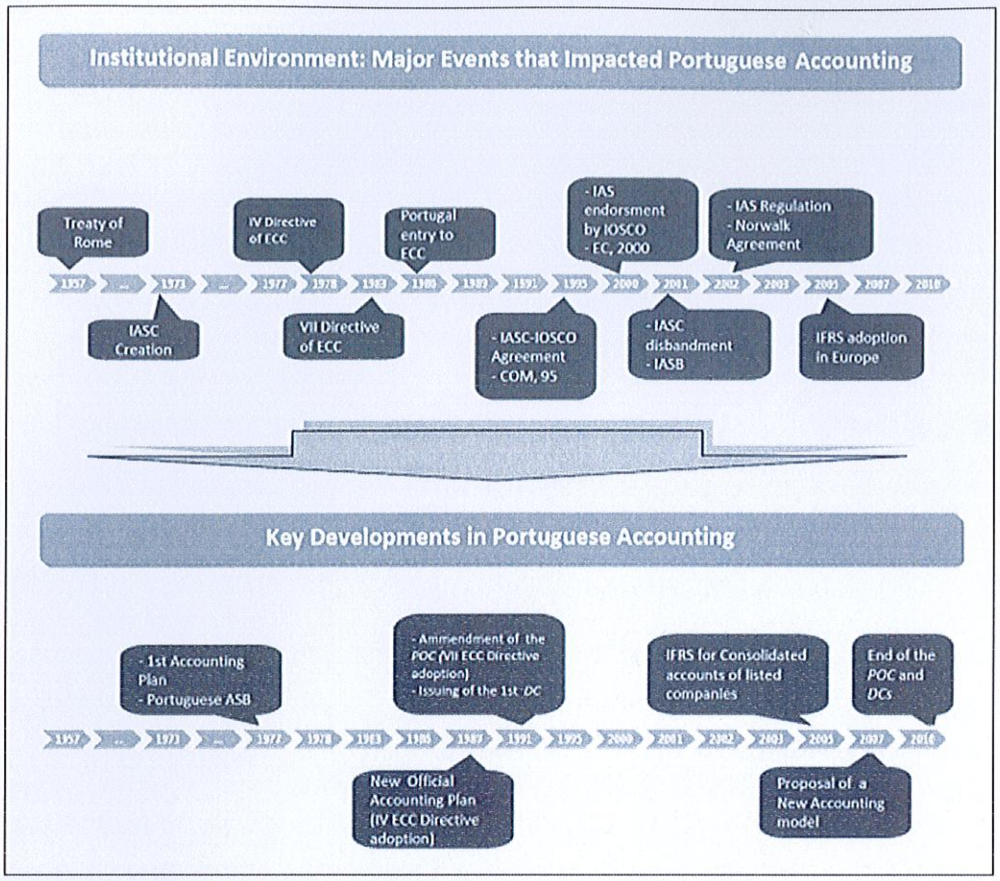

Figure 1. Major events that impacted on the Portuguese accounting system.

North (1990) argues, while formal rules may change overnight as a result of political decisions, informal rules and cultural constraints are much more impervious to deliberate policies. These cultural constraints not only connect the past with the present and the future but also provide the key to explaining the path of historical change.

In Figure 1, the key developments that occurred and impacted on the Portuguese accounting system, especially since the middle of the twentieth century, are presented.

5. Conclusion

In this article we use a new institutional economics perspective to explain the evolution of financial reporting in Portugal. We identify historically specific factors that condition the evolution of the accounting institution. The underlying assumption of this analysis is that internal and external events have been responsible for changing accounting through the years. As argued by McWatters (1998: 105), change in, and development of, accounting can be explained in large part in terms of response to local and time-specific environmental factors. North (1993) contends that the sources of change are the opportunities perceived by entrepreneurs and they stem from either external changes in the environment or the acquisition of learning and skills and their incorporation into the mental constructs of the actors.

The analysis that we provide reveals that the most important entrepreneurs were the *CNC* and its supportive state. Accounting standardisation was an important issue in Portugal only when the state understood the importance of accounting standardisation for the national system of accounts and for tax collection (when a new tax code defined that tax collection should be based on accounting numbers). Although the debate on accounting standardisation started at the end of the 1950s, the first accounting plan only appeared in 1977, after the Carnation Revolution. Within the political, economic, social and cultural changes that were taking place in Portugal, accounting standardisation was enforced by the state to reduce uncertainty and transaction costs (North, 1991). In the case of Portugal, the informational efficiencies realised through accounting evolution were at first closely intertwined with the extension of state taxation capabilities.

Until recently, the core of financial accounting and reporting in Portugal was the *POC*. As with the French Plan in France, its effects on financial accounting and reporting "have been deeply pervasive" (Standish, 1995: 176). More than providing a chart of accounts and the layout models of financial statements, the Accounting Plan (both the 1977 and 1989 versions) formed the basis for teaching and training accountants, with professional accounting being also organised on the basis of the *POC*. In a legalist country like Portugal, an emphasis on uniformity through standardised Accounting Plans was a better option to follow than the Anglo-Saxon judgemental accounting principles. The lack of development of the national accounting profession, and the emphasis on legality substantiates the need to enforce accounting provisions in laws. While the Portuguese accounting tradition gives preference to the information needs of creditors and the tax authorities, a change in emphasis is occurring, with international market pressures encouraging a much more investor/shareholder-oriented approach.

In the global arena, powerful institutional forces – such as the growing interaction between nation states, international organisations, multinational corporations, trade organisations, capital markets, and the Big 4 international accounting firms – led to the rising influence of the IASB and adoption of IFRS. With the EU supporting the harmonisation efforts of the IASB, the *CNC* also decided to issue *DC*s based on IFRS. Nevertheless, as previously happened, the legalistic character of Portugal led the *DCs* to be enacted in law. The growing importance of reaching international comparability and reducing transaction costs has led not only to the adoption of IFRS by listed companies, but also to the adaptation of the international accounting standards for the remaining companies.

The Portuguese model of accounting regulation was inspired by the French model. As in France, *CNC* is attached administratively and financially to the Ministry of Finance and has the power to develop accounting standards that are issued as decrees or decree-laws by the Portuguese Government. Therefore, accounting was closely linked to the state, "restricting the autonomy of the profession" (Bocqueraz, 2010: 50). Accountants have only been able to influence slightly the standardisation process through the Order representatives on the *CNC*. The restricted autonomy of the accounting profession related to financial reporting is a general characteristic of the European continental model of accounting.

Belgium, France, Portugal and Spain had a common legacy of tax reporting systems. It is possible to see path dependence as a consequence of the French invasion and the influence of the Colbert Ordinance. These countries have similar accounting standardisation processes leading to rigid uniform methods of accounting (accounting plans) that provided information to support public finance. However, these countries experienced different institutional changes concerning the IFRS adoption by unlisted companies: Belgium has not changed so far; France and Spain adapted the accounting plans (incremental change); and Portugal had a "revolutionary change" – that is, it revoked the accounting plan and issued accounting standards that are very similar to IASB standards. The British model that emphasises principles displaced the traditional Continental uniform methods approach which has been in vogue since the era of Colbert in the seventeenth century. Notwithstanding the difficulties and changes involved in accommodating a different philosophical accounting model, the *CNC* decided to extend IFRS influence to unlisted companies and individual accounts, adopting the *SNC*, a comprehensive model of IFRS as adapted for Portugal that replaced the *POC* and the *DCs*. Again, the legalist character of Portugal made it necessary for the publication of the *SNC* as a form of law. However, because accounting rules in Portugal are enacted in law, this does not mean that accounting practices changed overnight. In this regard, the new *SNC* presents a complete change of philosophy that puts increased responsibility on accountants' judgement. Additionally, in this new era, it appears that accounting will not be subordinated to tax laws and the Portuguese accounting profession will be able to use accounting rules adapted from the IASB model. However, as explained by the NIE framework, it is expected that the acceptance of the new paradigm will take time, since path dependence appears to be a much more fundamental determinant of long-run change; the assimilation of the new informal constraints will require "the reconstruction of prior theory and the revaluation of prior fact, an intrinsically revolutionary process that is seldom completed by a single man and never overnight" (Kuhn, 1970, quoted by Shortridge and Smith, 2009: 17).

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Notes

1. The term "new institutional economics" was firstly used by Williamson (1975) in order to make a distinction between "old institutional economics" and the NIE. However, NIE has its roots in two papers by Ronald Coase (1937; 1960). Additional important intellectual contributions that helped lay the foundations of NIE are those of North and Davis (1970), North and Thomas (1973) and Williamson (1975).
2. The SPC was founded on 28 January 1945. It fought strongly for the reform of technical teaching and for the regulation of accounting technicians (Rodrigues et al., 2003: 112).
3. The Portuguese Commercial Code was based on the "Colbert Ordinance of 1681, not substantially altered by the French Code of 1808", *Decreto-Lei 352/86*, p.1, 21 October 1986 (Decree-law 35, 31 October 1986).
4. The name was inspired by the events that occurred on the 25 April 1974 in Lisbon. Early in the morning of that day, a group of army officers of leftist tendencies led a military coup to take over strategic points of power in the country. The military forces quickly overwhelmed the government. The central flower market of Lisbon was flooded with carnations. The images of the Portuguese holding carnations and especially of the military putting those flowers in their gun barrels inspired the name of the "Carnation Revolution", putting an end to the longest authoritarian regime in Western Europe (UC, 1996).
5. The Portuguese Constitution of 1933 was introduced by Prime Minister Salazar, establishing the basis of the authoritarian *Estado Novo* (New State) regime. It established a bicameral parliament, including a Western-style National Assembly, elected directly every four years, and the Corporative Chamber, representing different "corporations", schools, universities, colonies and local municipalities. The role of the Corporative Chamber was limited to that of an advisory body, while all legislation was handled by the Assembly under the direction of its only party, the National Union, subordinate to Salazar's administration (see, http://www.infopedia.pt/$assembleia-nacional, accessed 7 June 2012).
6. See National Assembly, 25 March 1955, p. 675, available at: http://debates.parlamento.pt/search.aspx?cid=r2.dan, accessed 7 June 2012.
7. See, http://debates.parlamento.pt/page.aspx?cid=r2.acc&diary=ccl9sl2n56-0790&type=texto
8. Previous to this reform, companies' taxation was based on the "presumed income" that, according to some legal criteria, each company or activity, should generate (Decree No. 16731, 13 April 1929).
9. Available at: http://debates.parlamento.pt/page.aspx?cid=r2.dan, accessed 7 June 2012.
10. See National Assembly, 15 December, 1964, p. 4174, available at: http://debates.parlamento.pt/page.aspx?cid=r2.dan&diary=anl8sl4n169-4173&type=texto
11. Two additional Decree-Laws (No. 49381, 15 November 1969; and No. 147, 5 May 1972), on the auditing of limited companies, delineated some rules for the preparation of the balance sheet and the income

statement (Decree-Law 49381, 15 November 1969), and introduced the requirement to disclose an inventory of the company's financial participations (Decree-Law 147, 5 May 1972).

12. In the sequence of the Industrial Tax Code, two Government Orders from 1964 and 1965 recognised the need for more rigorous accounting that should be performed by "accounting technicians", who will be responsible for accounting in enterprises (No. 20317, 14 January 1964; and No. 21247, 27 April 1965). These developments led to the formation of a "Nucleus of Accounting Technicians" in the National Union of Professional Office Clerks (Noel Monteiro, 1980; Rodrigues et al., 2003).
13. In 1972, a Governmental Order formally recognised the auditing profession in Portugal (Rodrigues et al., 2003).
14. The *SPC* was a cultural association founded in 1945 to advance the knowledge of the "science of accounts" (Castel-Branco, 1970). This association "promoted conferences, disseminated accounting know-how, published the *Boletim da Sociedade Portuguesa de Contabilidade* (Bulletin of the Portuguese Accounting Society), established libraries, provided research facilities, and awarded scholarships and prizes" (Rodrigues et al., 2003: 112). The *SPC* also represented Portugal in several international conferences, "where Portugal would be ignored if not for this association" (Carqueja, 1974: 332).
15. The International Plan, the German, the Belgian, the Swiss and especially the French Plan were acknowledged by the Portuguese accounting scholars and professionals (see for example, Balagué y Doménech, 1965; Boucinhas, 1953; Moreira, 1953; Tomé de Brito, 1964).
16. The authors had two reasons for calling this study a "draft": first, to allow its public discussion, and second to postpone the decision of which companies would have to follow the Plan (Faveiro, 1973).
17. Comprising the following accounts groups: "Balance Accounts"; "Management Accounts"; "Income Accounts"; "Analytical and Exploration Accounts"; and "Order Accounts" (Noel Monteiro, 1970: 319).
18. The standardisation efforts developed in Australia, Austria, Belgium, East Germany, France, Greece, Italy, the Netherlands, Norway, Spain, Sweden, Switzerland, the UK and USA were classified and presented in two summary tables in the document "Accounting standardization – 1st Phase". The socialist models of Romania, Peru and the Soviet Union were also analysed (CNC, 1975).
19. Noel Monteiro (1977: 15) noticed the "supreme influence" of the Spanish and French Plan in the *CNC* draft, finding no influence by German and Italian scholars.
20. With the exception of banks and insurance companies, which followed specific accounting rules.
21. Management accounting was not considered in *POC/77*. According to the POC (1977, chapter 1, § 10), it should be developed on an industry-level basis.
22. According to the *POC/77*, financial statement users were the state and other public entities, employees, shareholders, creditors, lenders (particularly banks), companies, accounting professionals, managers and teachers.
23. Despite the crucial role of the events of the 1970s, a different approach to Europe had started in the early 1960s. An initial reason was due to the United Kingdom's negotiations to accede to the EEC. As stated by Lopes (1985), "with the first Community enlargement alone, the EEC's weight in Portuguese foreign trade automatically rose from 20 to 40 percent, while the EFTA's proportion fell from 36 to 14 percent". The importance of the British entry to the EEC was also highlighted by the Portuguese Prime Minister, Marcelo Caetano (1968–1974), when explaining the importance of signing a free-trade agreement with the EEC, on 22 July 1972, covering industrial and agricultural products. The Prime Minister stated that the entry of the UK into the EEC could not be ignored since this market represented 55 percent of Portugal's exports (Caetano, 1972).
24. In Portugal, the accounting and the auditing professions are regulated in a completely independent way and are under two different Orders: the Order of Registered Auditors and the Order of Registered Accountants.
25. This chapter was replaced by Decree-Law No. 79/2003, which made the Cash Flow Statement compulsory for companies following *POC/89*. The statement of sources and applications of funds stopped being compulsory and chapter 9 of *POC/89* became the "the cash flow statement".
26. Users of financial information are, according to *POC/89*: investors, lenders, employees, suppliers and other creditors, the state and other public entities, and the general public.

27. Additionally, the auditors' technical recommendations, issued by the Auditors' Order (*Ordem dos Revisores Oficiais de Contas, OROC*) and the disclosure guidelines of the Portuguese Securities Market Commission (*Comissão do Mercado de Valores Mobiliários, CMVM*) were also based on the IAS.
28. See, for example, Fontes et al. (2005) and IFAD (2001).
29. Despite the fact that the *POC* had played an important role in accounting standardisation since its issuance in 1977, its provisions were outdated and also insufficient for entities with higher demands for information. Additionally, *POC/89* was not comparable with IASB standards and not flexible enough to incorporate the continuing revision and issuing of IFRS (CNC, 2003, §27). The importance of the *DCs* in the national regulation was also highlighted, but they also presented several problems: *DCs* were not comparable among themselves, some approached accounting issues deeply while others did so superficially; new developments found no treatment in existing *DCs*, and while several of the *DCs* were based on IAS, most of those IAS had already been revised while the *CNC* never updated its standards (CNC, 2003, §29).
30. These elements are not prescribed in detail by IASB standards, but the CNC (2003) recommended its adoption by companies included in the first level of accounting standardisation, in order to guarantee the connection between the two levels of standardisation (CNC, 2003, §60).
31. The principle of fiscal neutrality is also used in Belgium (see Jorissen and Stabel, 2010: 23).
32. A working group on *SNC* of *OTOC* proposed that *POC* should be adapted to IFRS, following the examples of France and Spain; but this solution was not accepted by the *CNC*.
33. Both issues were debated in the parliament: the Portuguese Communist Party submitted a proposal to amend the limits of the accounting standard for small companies; and although the party *Centro da Democracia Cristã* proposed that micro-entities would not need accounting records, the accounting associations fought against it in the Parliament.
34. "Order" is the most important social status of a profession in Portugal (the association is now called *Ordem dos Técnicos Oficiais de Contas*).

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