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Teaching IFRS in Brazil: News from the Front[1]

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ABSTRACT *This paper presents a personal overview of the teaching of IFRS in a developing code law country, Brazil. It relates to teaching of undergraduates, MBA, MSc and executive students. The paper focus on the challenge to introduce IFRS concepts to a audience used to use accounting reports for tax purposes and not to inform external investors.*

KEY WORDS: IFRS, teaching, listening, Brazil

I. Introduction

In this paper I intend to provide a strictly personal account of my experience of teaching international accounting in Brazil. I have been involved with international accounting since 1998 when I started to teach the subject to undergraduate, executive and graduate audiences at the University of São Paulo (USP). During this time Brazilian GAAP was completely transformed in a process of convergence to IFRS, which was also somehow reflected in the teaching of financial accounting in Brazilian universities and also in executive training. My knowledge and background also evolved during this time. Regarding my academic background, I first majored in Accounting at USP in 1997, when I became a certified accountant, and then moved directly to a Ph.D. in Accounting and Control in the same institution which I finished in 2001. In the meantime, I spent the academic years of 2000 and 2001 at the London School of Economics (LSE) as a Doctoral Fellow which involved my holding teaching and research assistantships. Subsequently—I was already a member of the faculty at USP—I went to the University of Manchester (Manchester Business School—MBS) where I took a Ph.D. in Accounting and Finance.

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During my Ph.D. studies at the MBS I was also a visiting scholar at the Arizona State University in the USA.

Back in Brazil I taught accounting to undergraduate, MBA and Ph.D. students at USP. I also undertook extensive teaching of executives and professional accountants in seminars and training programs. In the UK I had been a teaching assistant in both Financial Accounting and Principles of Finance (at both LSE and MBS). Alongside these academic activities, I consulted for large Brazilian public companies and financial institutions in topics related to accounting for financial instruments—especially derivatives—and also on IFRS implementation before I became a Commissioner at the Securities and Exchange Commission of Brazil (the position which I hold currently on a five year term from January 2010). I am also a member of the Education Advisory Group and of the IFRS Advisory Council of the International Accounting Standards Board (IASB).

Based on my personal experience and background, this paper is intended to provide a narrative of the impact of the IFRS convergence process on the teaching of accounting in Brazil. This paper reflects my personal views which are influenced by the evolution of financial accounting in Brazil as well as on my professional and personal experiences during this time—all limitations and biases included. All views presented here are my own and do not reflect on the official positions of the Securities and Exchange Commission of Brazil or of any other body or organization. In the next section, I discuss the accounting environment in Brazil prior to the convergence process; in section III I discuss the convergence process and its unique evolution in Brazil; in section IV, I discuss teaching financial and international accounting in such a dynamic environment; and in section V, I conclude the paper.

II. Accounting and Corporate Financial Reporting in Brazil Prior to IFRS

In this section I discuss the accounting environment in Brazil prior to the issuing of the Law 11.638/07, which formally started the convergence to IFRS process for all Brazilian public companies, which will be better explained in the next section. Considering prior literature as a benchmark, and focusing on the informativeness[3] of accounting reports, my analysis is based on the framework provided by Ali and Hwang (2000). Brazil met at least four of the five criteria that Ali and Hwang (2000) showed to be related to the uninformativeness of accounting numbers. First, Brazil had a bank-oriented (as opposed to market-oriented) financial system. In Brazil a small number of banks supplied most of the capital that firms needed and, as a consequence, there was a lower demand for published financial reports than is found in developed markets—a scenario commonly found in emerging economies as described by Nobes (1998).

Second, private sector bodies had little or no influence over the accounting standard-setting process. Government authorities established accounting rules to address a number of regulatory needs instead of to inform equity investors. Previous research (Anderson, 1999) has suggested that interventionist states directly affect the contracting process in the economy by adding uncertainties over the enforcement of contracts and political influence. Unlike the situation in Brazil, private-sector influence on standard setting is normally observed in common law countries (the Accounting Standards Board in the UK and the Financial Accounting Standards Board in the USA being the obvious examples). In this aspect, the influence of private sector bodies on the regulation of financial accounting is highly correlated with the equity-outsider investor model, which is a usual feature of common law countries with developed public equity and debt markets (Class A countries according to Nobes, 1998). In Brazil, all accounting rules were issued directly by the central government or by one of the agencies having responsibility for specific guidelines.

The Brazilian Company Law (Law 6404 of 1976) provided the accounting framework for firms listed on the São Paulo Stock Exchange (Bovespa). In addition to this law, the Securities and Exchange Commission of Brazil (CVM) issued norms that regulate specific accounting questions. While the CVM-mandated rules were considered to be GAAP in Brazil, they could not be in disagreement with what is required by the Company Law. Financial institutions were and still are regulated directly by the Central Bank of Brazil, which mandates specific standards for the accounting statements of financial institutions. In addition to the Company Law and CVM, Brazilian firms had to comply with specific accounting guidance provided by the tax authority (SRF). Insurance and private pension companies had their own regulators (SUSEP and SPC, respectively). Despite this structure, sometimes exogenous political pressures were impounded on accounting matters. In 1999, for example, the government authorized firms to defer losses on exchange rate devaluations. This deferral was not possible under the CVM rules. In addition, professional accounting bodies had no direct power to influence the standard-setting process in Brazil.[4] Brazil clearly was a Class B country is this matter and, as discussed by Ali and Hwang (2000), this aspect is likely to reduce the value relevance of published accounting numbers in Brazil.

Third, Brazil was considered to be a continental model country because its financial reporting system was strongly influenced by its Portuguese colonizers. As expected (Ali and Hwang, 2000), the value relevance is lower for continental model countries (Class B countries) than for British-American model countries (Class A). This result is not surprising, because British-American model (common law with developed equity and debt markets) countries are more likely to have equity-outsider financial systems with dispersed ownership structures. Complementarily, Nobes (1998) discusses the concept of culturally self-sufficient and culturally dominated countries. As is the case in South America (former Spanish and Portuguese colonies), Brazil was culturally dependent and clearly adopted a continental model accounting structure despite the fact that the accounting rules disposed in the Company Law were inspired by US-GAAP. As Anderson (1999) comments:

> . . . the quality of disclosure by Brazilian firms is perceived to be low. South American accounting practices are dominated by the legal and administrative systems inherited from the Iberian colonizers and the "highly political" environment that result from such systems.

Costa (1993)—the first president of CVM and later a Trustee of the IASC Foundation—commented that Brazilian annual reports were not really prepared to inform investors, but rather to comply with regulations (Class B country). Based on the evidence from Ali and Hwang (2000), this aspect is likely to reduce the value relevance of Brazilian accounting numbers. Another important characteristic of Brazil was the high state participation in the economy which, according to Leuz and Oberholzer-Gee (2003), contributed to reduce the transparency of accounting reports.

One could argue that Brazil possesses a hybrid model. Some of its rules are influenced by US-GAAP while the institutional environment is characterized as a Class B country. In this paper I am not solely concerned with the accounting standards and regulations but also (and mainly) with the actual properties of the published accounting reports. Despite the fact that some accounting rules in Brazil were influenced by American standards (and that the CVM also ruled several norms in accordance with IAS), the whole of its accounting infrastructure was not based on the production of information for capital markets. Thus I believe it is reasonable to assume that Brazil is a class B country as proposed by Nobes (1998). Recent research, however, has shown that firm-level characteristics also have an important influence on the properties of published accounting reports (Lopes and Walker, 2010) and that it is not proper to assume homogeneous quality across firms within a country.

Fourth, tax rules had a strong influence on Brazilian financial reporting, and sometimes financial accounting reports and tax reports were almost indistinguishable. Ali and Hwang (2000) found evidence that value relevance is lower when tax rules significantly influence the financial reporting process, consistent with the assumption that tax rules are influenced by political and economic determinants rather than the needs of equity investors. According to Nobes (1998), the influence of tax rules is greater in Class B countries, where published financial statements are not the primary source of information to investors because tax laws are clearly influenced by a wider range of factors than the needs of equity investors. In Brazil tax rules had an enormous influence on accounting reports and most firms choose to adopt, for financial reporting reasons, the same treatment allowed for tax purposes.

Finally, Ali and Hwang (2000) find that value relevance is higher when more is spent on external auditing. This is expected, since external auditing is more likely to be extensively used in equity-outsider markets (Class A countries). However, I cannot comment on this aspect because I do not have empirical evidence on this matter.

Despite the structure presented above, some additional considerations are necessary to characterize the corporate financial reporting environment in Brazil. First, Brazil possesses a large and active professional accounting community with more than 400 000 members affiliated to the Brazilian Council of Accountants—including university-trained accountants and technicians. Accounting academia was relatively well-developed, especially at the University of São Paulo which conducts bachelor's, master's, MBA and Ph.D. programmes in Accounting. Brazilian academics developed a very sophisticated method to account for inflation which was used until 1995 and was based on Edwards and Bell's concept of economic income and capital maintenance. Over the last decade graduate programs started to flourish in other parts of the country and accounting academia developed a rich net of events, seminars, journals and other infrastructure arrangements which could be considered as signals of a nascent academic accounting community. This could also be observed by the growing number of graduate students who move abroad to complement their training. Alongside these developments, accounting research also became more positive-oriented (economics) departing from the old established normative tradition usually performed in the country. Accounting academia in Brazil is developing fast and the quality of the works produced has been consistently increasing which somehow shows the growing importance of the subject.

In the professional arena some important signals of growing importance are easily observed. The status of accountancy is improving significantly and it is being reflected in the demand for well-trained professionals. This is also reflected in the willingness of students to obtain bachelor's degrees in accounting. Brazilian accountants are also more actively participating in international organizations and bodies and contributing more directly to the international debate.

III. The Convergence to IFRS in Brazil

The accounting scenario presented in the last section received little or no criticism during the 'lost decade' of the eighties (1980's) in Brazil. With anaemic capital markets and almost no private funding for firms, little attention was paid to financial statements as providers of information about firms. The situation was also coupled with macroeconomic crises which generated two digit inflation rates (monthly) also contributing to reduce the reliability of financial statements.[5]

However, the Brazilian economy started to change with the macroeconomic stabilization program started in the mid-1990's (the Real plan). This program dramatically reduced inflation and gave public finances some discipline. Gradually the Brazilian economy started to operate on more reasonable levels and capital markets started to flourish. Initially, Brazilian firms started to look abroad to finance their growth options through the issue of American Depositary Receipts because companies faced important growth opportunities locally but did not have access to local funds.[6] This happened basically because a significant part of the national savings was allocated into public notes paying high interest rates, thus reducing dramatically the demand for stocks and corporate bonds. In this period US-GAAP was very popular among the largest Brazilian corporations because of the huge importance of the American capital market as a source of funds for companies. As expected, most of the firms accessing US markets were very large corporations which have been public companies for some time.

In the early years of the twenty first century Brazilian companies started to find important funding opportunities in the local markets both for equity and debt capital. There was an upsurge in the São Paulo Stock Exchange (Bovespa) during this period. IPOs became frequent with more and more Brazilian firms accessing local markets looking for capital. Brazil also became classified as 'investment grade' by the major rating agencies. This new reality increased the demand for informative accounting reports. Another relevant factor was the reduction in ownership concentration which had been extremely high in past years. Coupled with this new reality, and the claim for more informative accounting reports, the CVM started to issue norms in accordance with IFRS (e.g. the rule on employee benefits which was inspired by IAS 19). However, full convergence with IFRS was not possible because CVM could not issue rules in disagreement with what was disposed in the Company Law which differed significantly from IFRS. In an important first step in 2006, the Central Bank of Brazil issued a norm requiring all major financial institutions to present IFRS consolidated financial statements by the end of 2010. The same step was followed by CVM in 2007 which required the same for public companies. At this point convergence in Brazil was going to be mandatory only for consolidated financial statements by the end of 2010, and without full legal support.

However, in December 2007, a landmark event occurred: the Law 11.638 was passed. This Law gave a mandate to CVM to converge Brazilian GAAP to international standards and to celebrate an agreement with a private sector body which should be responsible for issuing norms in full compliance with IFRS for all Brazilian companies under CVM jurisdiction. These norms were to be issued by the Brazilian Accounting Standards Board (CPC) and would be valid for individual and consolidated financial statements.[7] At the end of the process of convergence, Brazilian GAAP would be virtually non-existent and full compliance with IFRS would be mandatory for all firms under CVM jurisdiction. Later this process was amplified to include all Brazilian firms because the Brazilian Council of Accountants (CFC) also decided to follow CPC decisions which resulted in CPC (IFRS) rules becoming mandatory for all Brazilian firms. Small and medium-sized enterprises were obliged to use the IFRS standard for SMEs.

The Law was also important for another reason. It strictly separated financial and tax accounting. Companies should therefore prepare financial statements according to CPC rules and then adjust their records to calculate taxable profits. Tax rules would not interfere with accounting rules anymore. Brazilians refer to this new decision as the 'tax neutrality' of the new accounting rules.

Instead of adopting CPC rules at a single point in time the adoption in Brazil followed a two stage process. Fifteen CPC rules were adopted by the end of 2008 with those remaining scheduled to be adopted by the end of 2010. Consequently, financial statements published in Brazil at the end of 2008 were a mixed IFRS BR-GAAP model. In 2009 the full adoption of IFRS was optional and in 2010 it became mandatory for all firms under CVM surveillance. This two stage process was designed to allow companies to prepare themselves as well as auditors, accountants and other professionals involved in the change.

The reception of IFRS in Brazil was relatively good among companies and the capital market as a whole, mainly because IFRS was immersed in a wave of market reforms designed to make capital markets in Brazil more competitive. During the first decade of the twenty-first century Brazilian public debt and equity markets developed a lot and market participants were keen to attain global market status to be able to attract foreign resources. This was what actually happened and some of the biggest share offers in the world in 2009 were made via the São Paulo Stock Exchange.

IV. Teaching

Having being a student and teacher of accounting in the UK and in Brazil—countries that possess very distinct accountings systems with the UK being very investor-oriented as opposed to the Brazilian model—gave me a perspective about how the differences in the two accounting systems were not only technical but actually much more profound. In Brazil, accounting was basically seen as a tool to calculate taxes and not as an instrument to reduce information asymmetry between investors and firms. The whole subject of disclosures including how to prepare footnotes, for instance, despite being demanded by the Law, were not even taught at universities on accounting courses. As I have heard from a professional explaining the poor disclosure levels observed in the country '…nobody taxes footnotes!' Fair value was so distant a concept that most accountants in Brazil used to say that measuring fair value was a step towards other professions' domains (e.g. that of economists).

Thus, teaching IFRS in Brazil has been a challenging experience. This is not because of the dynamic rules since Brazilian accountants are used to an enormous amount of dynamic and confusing rules. The big problem was that, in order to move to IFRS, Brazilian accountants have also to change their perception about the profession and themselves. The label 'contador (accountant)' should convey a more diverse meaning than it did before. The role that professional accountants are now supposed to perform in corporations is very distinct from what they used to do. For instance, accountants in Brazil were not used to value things. All the measurement process (historical cost bases, depreciation rates, etc.) was exposed in the tax rule. Nobody used to care about actual depreciation rates or the actual realizable value of inventories, for instance. The whole process was simplified—just follow the tax rule. This new accountant, fluent in valuation techniques, was something quite distant from the profession in Brazil.

Another important departure from the traditional Brazilian accounting model occurred in the recognition area. Accounting in Brazil was also dictated by legal form rather than substance. Most transactions were accounted for in disregard of their economic meaning—as in the typical case of leases. Brazilian accountants were also not accustomed to thinking about the true conceptual economic meaning behind transactions. They accounted for transactions basing their judgments on the way in which contracts were established and not on the underlying economic phenomena.

In order to have any success teaching IFRS for professional accountants in Brazil, someone would really need a solid grasp of the foundations of the discipline in order to justify the new concepts. Every concept was challenged by students at every possible opportunity in classes. Most senior members of the profession were keen to distrust IFRS as being 'too subjective' and 'easy to manipulate'. To be able to apply IFRS, accountants need a set of skills which, at least in Brazil, are more associated with other professions (e.g. economists and valuation). Thus, the very first step was to change people's perceptions of what accounting is, for whom it was being undertaken and, fundamentally, what the term 'accountant' really means.

As accounting moved from a record-keeping technique to a broader role involving valuation of financial instruments, impairment of assets, essence over form considerations, consolidation based on the power to govern rather than on equity participation, among other changes, the set of skills and personal demands over the profession created the need for a new professional. This new professional—able to use professional judgment instead of only recordkeeping—had to be developed and trained in Brazil. These new professionals were not there waiting—they had to be created.

This process was not only influenced by educational programs but also by marked demands. Accounting suddenly became a hot topic—newspaper coverage of accounting matters, for example, increased dramatically. However, the resistance of the seasoned professionals was strong and the training process difficult.

In the undergraduate (junior years) arena the situation was rather different. Instead of resisting the new concepts, undergraduate students became quite impressed about their discipline's new status and perceived importance. Consistently, teaching was easy and more rewarding as students were keener to learn and less concerned about the old world which they had not experienced. When discussing some concepts such as essence over form some students asked: Why was this not always done this way? Why could someone not consider doing impairment tests before?[8] I am not saying that everything was perfect and that all IFRS concepts were accepted and understood perfectly (e.g. IAS 39, for example, is a case of confusion but as Sir David Tweedie said recently 'If you have read IAS 39 and understood it completely you have not read it properly.') What I am saying is that the whole idea of economics-based financial statements providing useful information for external users and the new role of the accountant were much more easily accepted by undergraduates than by more experienced professionals.

The real challenge to teach junior students resides more on the faculty side. Some members of the faculty team were also (like professionals) a little resistant in changing their methods and especially their views about what kind of professionals they need to educate and foster. Not all members of the faculties in Brazil presented the same level of resistance but, in general, it was significant. The introduction of IFRS can be considered as a shock to Brazilian accounting academia. As usual, some saw it as a great opportunity to improve their position but most of them showed some resistance to the new concepts—even arguing that these resided outside the core competencies of accountancy. Thus it took a great deal of leadership in the main institutions to change the general mindset and to motivate the faculty to be adequately prepared to teach the new students.

A significant improvement was necessary in teaching materials (textbooks, cases, etc.) but mainly in teaching philosophy and attitude. Classes in Brazil tended to be rather technical, focusing on double-entry procedures and not on conceptual questions. Students were normally told about the depreciation rates to be used, the provisions to be accounted for and so on. No actual discussions took place on the appropriateness of the measurements to situations being considered. Students were expected to be able to account for transactions but not to judge the adequacy of the measurements made. There was almost no judgment or decision-making involved. To be able to teach the new procedures adequately, the teachers had not only to change their teaching materials but also to include a great deal more of economic reasoning and judgment in the exercises and cases to be solved. This obviously consumed long hours and significant effort. For some this task was unattainable once they did not share the same IFRS-view about what accounting is and what it should be doing.

Colleges and universities also had to modify the existing curriculum in order to adapt to the new demands of IFRS. An especially important topic was the inclusion of more syllabuses related to economics and finance because the new standards demanded significant knowledge of these subjects. Consequently, a special demand was created for faculty well trained in these new techniques and methods, and also with a reasonable level of understanding of these related disciplines.

In the executive teaching arena analysts (equity and credit) were very receptive to the new accounting methods. Comments normally were related to the complexity of the new standards and how much information could actually be provided.[9] These external users were also very concerned with the reliability of the new estimates as well as with the auditing process. Most companies with which I had contact praised the new standards and one commented '... this new accounting rule really changed the way I report my figures and now everything makes sense.'

V. Conclusions

My experience with IFRS teaching in Brazil is of a major revolution. The new rules required a new kind of professional very distinct from the traditional record keeper. To teachers the major challenge was not technical but inspirational. Students needed to be motivated for this new world and the coming professional redefinition. The situation and the challenges in Brazil are not really about the adoption or not of IFRS *per se*. The main challenges arise with the adoption of an accounting model designed to inform external users and based on judgment, and on the economic substance of transactions, in contrast to the local model, which was designed to attain other ends. The situation would be similar if the convergence was towards UK-GAAP or any other accounting system designed to inform external parties.

The future holds many challenges for the construction of a high quality accounting system in Brazil. Of the many challenges ahead, one that captures my attention is the adoption of IFRS for small and medium enterprises. The rationale for adoption of a highly informative accounting system for public firms and firms which are accountable to a large community of stakeholders is clear and undisputable. The situation is rather different when the discussion moves to SMEs. For those firms the challenge will be even more dramatic given that the positive outcomes of such a big improvement in terms of accounting models are not so clear. What is the appropriate conceptual framework for the production of high quality accounting numbers for SMEs? Is it similar to the one currently in use for large corporations? How should this subject be taught? Several questions remain unanswered and proper answers should not be taken for granted in the convergence process.

Notes

[1]This paper is based on lecture given at the IASC Foundation and IAAER co-bannered session for IFRS Teachers, Trainers and Researchers which took place in 12 June, 2009 in São Paulo, Brazil.

[2]Commissioner at the Securities and Exchange Commission of Brazil, Professor of Accounting at the University of São Paulo and member of the IFRS Advisory Council and of the Education Advisory Group of the IASB. Opinions expressed in this paper do not represent official positions of the Securities and Exchange Commission of Brazil but solely the personal views of the author.

[3]I consider informativeness as a feature related to the reflection of underlying economic reality on accounting figures. Special attention is given to the degree upon which accounting earnings reflect changes in the economic value of firms. Earnings are considered to be informative if they properly reflect changes in the value of corporations to which they are related.

[4]The Brazilian Securities and Exchange Commission (CVM) usually sponsored consultative meetings with the Brazilian Institute of Auditors (Ibracon) and members of academia. However, results from these meetings do not have legal standing over what was prescribed by the Law.

[5]Brazilian academic accountants developed in this period a very sophisticated method to account for inflation in financial statements which later became mandatory. This method was used for financial accounting and tax purposes and it stopped being used in 1995.

[6]Brazil was the world's largest ADR issuer. See http://www.adr.com

[7]Individual financial statements are required by the Brazilian law and are the basis for tax, dividends and most covenants decisions.

[8]These were the questions I normally received.

[9]I also participated as an observer at meetings of the Brazilian Accountings Standards Board (CPC) and I could see some of the reactions to the new rules being passed.

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