



EXTENDED DOCTORAL ABSTRACT

The enforcement of accounting standards and the quality of financial information

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ABSTRACT

The adoption of a set of high-quality standards by companies – the International Financial Reporting Standards (IFRS) – was considered one of the biggest steps in the recent accounting history. However, the existence of high-quality standards per se is no guarantee of quality financial information and financial reporting (Cho et al., 2015; Quagli et al., 2018). Recently, the literature (e.g., Alexandre & Clavier, 2017; Demmer et al., 2019; Gao & Sidhu, 2018; Gu et al., 2019; Oz & Yelkenci, 2018; Wijayana & Gray, 2019) argues that the quality of financial information is only possible with rigorous accounting enforcement.

Enforcement is considered a compliance analysis of financial information disclosed by entities to ensure that IFRS are being correctly applied (ESMA, 2014, p.9). It is a system to prevent, identify and take necessary actions in cases of material errors or omissions in the application of IFRS (or other accounting standards). Therefore, according to the Federation of European Accountants (FEE), currently designated Accountancy Europe, accounting enforcement comprises six levels: self-enforcement; statutory audit of financial statements; approval of the financial statements (administration boards); institutional oversight systems; court complaints and sanctions; and public and press reactions (FEE, 2001).

In recent years, enforcement has been growing in importance (Anagnostopoulou, 2017; Daher, 2017; Duru et al., 2018; Eutsler et al., 2016; Preiato et al., 2015). It is recognized that it plays a key role in encouraging the production of high quality

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financial information (Alexandre & Clavier, 2017; Brown et al., 2014; Christensen et al., 2013; Gu et al., 2019; Kavanagh, 2017; Leuz, 2010; Oz & Yelkenci, 2018; Peña & Franco, 2017).

However, although the concept of enforcement appeared after the wide acceptance of IFRS (in the European Union (EU), particularly from 2005), enforcement mechanisms have not yet been implemented in some countries or, where implemented, the consequences and impacts of enforcement on the quality of accounting information, have not been empirically assessed yet (ESMA, 2017; Mantzari & Georgiou, 2019). The literature has also been arguing about the scarcity of studies that actually assess the enforcement practices of countries (e.g., Böcking et al., 2015; Guerreiro et al., 2020; Kleinman et al., 2019; Moura & Gupta, 2019; Preiato et al., 2015; Silva & Rodrigues, 2017).

The main overall objectives of this thesis were understanding how enforcers work/act to ensure compliance with business accounting standards, and the impact of their action on the quality of financial information, taking Portugal as the context for the empirical study. To achieve these objectives, four scientific articles were prepared as presented below:

Paper 1 – The aim is to identify, recap and analyze the current state of research on the relationship between IFRS enforcement and accounting quality, in order to provide a critical overview of publications in this field, and to identify future areas of interest. Supported by a structured literature review, this paper fills in a research gap by conducting a scientometric analysis of papers on the relationship between IFRS enforcement and accounting quality understood in a broad sense. It reviews papers published between 2006 and 2019 selected from the Web of Science database, particularly analyzing main journals, authors, geographic areas of study, research methods applied, specific topics explored and future lines of research to be developed. Main findings showed a scarcity of studies analyzing IFRS enforcement practices in individual countries and, subsequently, of the impact these practices may have on the accounting quality. Also, they evidenced prevalence of quantitative approaches. This research corroborated the studies of Guerreiro et al. (2020), Kleinman et al. (2019), Mantzari and Georgiou (2019) and Moura and Gupta (2019), which indicate the lack of studies actually assessing the enforcement practices of countries. The gap found calls for further research to know the effectiveness of the IFRS-related enforcement mechanisms, in practice, namely resorting to qualitative analyses.

Paper 2 – This paper analyzes the enforcement practices regarding the international accounting standards in Portugal, seeking to understand how enforcers act to control IFRS compliance. The study relies on deep analysis of documentary

sources and semi-structured interviews about the institutionalization of IFRS enforcement in Portugal, adapting the institutional model of Dillard et al. (2004) and the deinstitutionalization concept of Oliver (1992) to interpret the main findings. Accordingly, there is evidence that legitimacy structures characterize the performance of Portuguese official entities responsible for controlling the application of IFRS, namely by Securities Markets Authority (*Comissão de Mercado de Valores Mobiliários* – CMVM). With this legitimacy, the actors exercise structures of domination and signification spread across lower institutional levels (Institute of Certified Auditors (*Ordem dos Revisores Oficiais de Contas* – OROC); statutory auditors of public-interest entities). However, due to bidirectional pressures between the levels of action, there is a significant part of the control of compliance with IFRS which, despite provided for by law, is not being exercised (Institute of Certified Accountants (*Ordem dos Contabilistas Certificados* - OCC), leading to the deinstitutionalization of enforcement practices. Considering several scandals involving Portuguese banks, for example, and the empirical data collected, the study showed that, although the enforcement mechanisms are provided for in the Portuguese legislation, they may not be working in practice.

Paper 3 – This study analyses the practices of enforcement concerning the national accounting standards (*Normas Contabilísticas e de Relato Financeiro* – NCRF) in Portugal, seeking to understand how enforcers act to control compliance with those financial reporting standards. As in the second paper, this research relies on documentary analysis and semi-structured interviews to the various enforcers. Findings were framed within institutional dynamics, following the Dillard et al. (2004) model and Oliver’s (1992) deinstitutionalization concept too. Main conclusions revealed that, although the criteria are defined at the economic and political levels (by the Accounting Standards Board (*Comissão de Normalização Contabilística* - CNC)), control has not been put into practice (decoupling), failing to comply with their duties of controlling the application of accounting standards. At the organizational field level, although the quality control system of OROC is being applied, this is not the case for the quality control of OCC. OCC’s quality control has been suspended due to the pressure exercised by the professionals (certified accountants). Decoupling practices can be observed (the criteria exist but they are not being applied) and, consequently, there was a deinstitutionalization of practices previously institutionalized. This calls into question the effectiveness of the enforcement system of the country (Portugal) and ultimately the true and proper view to be offered by the companies’ financial statements (in this case, those prepared under the Portuguese Accounting Standardization System (*Sistema de Normalização Contabilística* - SNC)).

Paper 4 – This study aims to analyze the impact of the three levels of enforcement (audit committee, external audit, and oversight system) on the quality of financial

reporting. Data was collected from 76 Portuguese companies for the years 2017-2018, the only years with availability of data at the moment of the analysis. The quality of financial reporting was measured using discretionary accruals (Kothari et al., 2005). This panel regression considers both the cross-sectional and time-series effects and is based on firm-year observation with a Fixed Effects Model. The results of the multiple regression analysis showed that only the independence of the audit committee and the quality of the external auditor have a positive impact on the quality of financial reporting. The association between the two enforcers (audit committee and external auditor) also has a positive impact on the quality of the financial reporting. However, the oversight system has no impact on the quality of the information reported, which agrees with the findings of the qualitative papers in this research (papers 2 and 3), where accounting enforcement (namely from CMVM) does not appear to be very effective in practice yet.

This thesis is composed of a set of four research papers. By using a variety of methodologies (qualitative and quantitative), as well as different perspectives of the institutional theory in the research process, the study contributes to a better understanding of the enforcement of accounting standards, in Portugal and overall, and of its impact on the quality of financial information.

As to contributions for practice, this thesis in general underlines the leading role of ESMA but, at the same time, shows, taking evidence from Portugal, that enforcers in member states may not be working as they should, so the quality of IFRS-based financial information ultimately published may not be as expected. Therefore, our research is of particular interest to standard-setting bodies, regulators, enforcers, and users of financial information, especially in Europe, inasmuch as it may support policy-making in terms of accounting standards enforcement regulations.

Another important implication for practice to derive from this study is that, in countries such as Portugal, where the standard-setter (CNC) ends up to have weak enforcement power, tax authorities need to ensure the control of implementation of national accountings standards, hence safeguarding that accounting and financial reporting quality is attained.

Moreover, while highlighting that enforcement mechanisms are provided for in the Portuguese legislation, but they may not be working in practice, this research points out the need of Portuguese authorities to establish policies to make IFRS enforcement more effective, particularly regarding banks and insurance companies, and unlisted companies that are using IFRS. As to the enforcement of the SNC, it shows the need for more means to be provided to CNC, so they can exert proper control of the enforcement of the national accounting standards.

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