Portuguese Accounting

The Portuguese standard setting process started almost 40 years ago with the establishment of tax laws. As a member of EU, the Portuguese accounting system is strongly influenced by Fourth and Seventh Directives and the most recent standards are very similar to IASs, revealing a harmonization effort.

The Portuguese Accounting Standards Board (CNC - Comissão de Normalização Contabilística) was set up in 1974 by law and has revised several times since, the last being in 1999.

Global Harmonisation

As in many others continental European countries, Portuguese accounting consists on a codified system of law. The first significant attempt to harmonize accounting practices occurred in 1963 with a profound tax reform, which contained some implicit accounting regulations. Only in 1977 an accounting regulation was established with the promulgation of the first Official Plan (POC - Plano Oficial de Contabilidade).

Recent changes

Portugal only recently started to realise the crucial importance of a comprehensive set of accounting rules. In 1989 a new Plan was issued in accordance with the recent developments in international accounting and the adoption of Fourth Directive and it was slightly revised in 1991, in accordance with the Seventh Directive.

Standard Setting process

Accounting standards (DCs) are developed through a very close due process that involves only the members of CNC and a few well-known individuals. The due process is weak. The agenda is established internally, there is very little formal information to the public and there is no period for public comment.

The process begins with the inclusion of a project on the Board's agenda. Once the Board has added a project to it's work programme, it sets up a working group to develop draft, which if approved and homologated by the Minster, is issued as a standard.

Compliance

Some of the standards are in compliance with IASs. DC nº 18 establishes a hierarchy of GAAPs, adopting the IASs in any subject not covered by the POC or DCs.
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Some subjects treated by the Portuguese standards are marked as "not covered by any standard", because they are not a comprehensive and consistent treatment. For instance, the POC allows the capitalization of Borrowing Costs, but does not preclude any treatment, method or condition to this treatment.

IASC		Portuguese GAAP
	Conceptual framework	Portugal don't have an explicit conceptual framework, but some subjects are covered by POC and DC 18
IAS 1	Presentation of Financial Statements	POC, DC 14 and DC 20
IAS 2	Inventories	POC and DC 22
IAS 4	Depreciation Accounting	POC
IAS 7	Cash Flow Statements	DC 14
IAS 8	Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies	POC and DC 8
IAS 10	Events After the Balance Sheet Date	Not covered by any standard
IAS 11	Construction contracts	DC 3
IAS 12	Income Taxes	Not covered by any standard
IAS 14	Segment Reporting	Not covered by any standard
IAS 15	Information Reflecting the Effects of Changing Prices	Not covered by any standard
IAS 16	Property, Plant and Equipment	POC and DC 16
IAS 17	Leases	DC 25
IAS 18	Revenue	DC 26
IAS 19	Employee Benefits	DC 19
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance	Not covered by any standard
IAS 21	The Effects of Changes in Foreign Exchange Rates	POC and DC 21
IAS 22	Business Combinations	DC 1, DC 12 and DC 13
IAS 23	Borrowing Costs	Not covered by any standard
IAS 24	Related Party Disclosures	Not covered by any standard
IAS 25	Accounting for Investments	Not covered by any standard
IAS 26	Accounting and Reporting by Retirement Benefit Plans	Not covered by any standard
IAS 27	Consolidated Financial Statements and Accounting for Investments in Subsidiaries	POC and DC 6
IAS 28	Accounting for Investments in Associates	POC and DC 9
IAS 29	Financial Reporting in Hyperinflationary Economies	Not covered by any standard
IAS 30	Disclosures in the Financial Statements of Banks and Similar Financial Institutions	Specific accounting plan for bank sector
IAS 31	Financial Reporting of Interests In Joint Ventures	DC 24

IAS 32	Financial Instruments: Disclosures and Presentation	Not covered by any standard, DC 17
IAS 33	Earnings Per Share	Not covered by any standard
IAS 34	Interim Financial Reporting	Not covered by any standard
IAS 35	Discontinuing Operations	Not covered by any standard
IAS 36	Impairment of Assets	Not covered by any standard
IAS 37	Provisions, Contingent Liabilities and Contingent Assets	Not covered by any standard
IAS 38	Intangible Assets	Not covered by any standard, R&D: DC 7
IAS 39	Financial Instruments: Recognition and Measurement	Not covered by any standard, DC 17
IAS 40	Investment Property	Not covered by any standard
IAS 41	Agriculture	Not covered by any standard

List of Current DCs:

DC nº 01/91 Business combinations
DC nº 02/91 Accounting for donations
DC nº 03/91 Construction contracts
DC nº 04/91 Contractual liabilities of a concessionary company
DC nº 05/91 Revenues and liabilities inherent to a gambling concession
DC nº 06/92 Elimination of intercompany transactions
DC nº 07/92 Research and development costs
DC nº 08/92 Retained earnings: clarification of the concept 'infrequent and significant corrections'
DC nº 09/92 Accounting for investments in subsidiaries
DC nº 10/92 Leases – Transition treatment
DC nº 11/92 Accounting for VAT
DC nº 12/92 Goodwill concept
DC nº 13/93 Fair value concept
DC nº 14/93 Cash flow statements
DC nº 15/94 Shares remission and amortization
DC nº 16/95 Revaluation of tangible assets
DC nº 17/96 Accounting for futures contracts
DC nº 18/97 Objectives of financial statements and generally accepted accounting principles
DC nº 19/97 Employee benefits
DC nº 20/97 Income statement: functional classification scheme
DC nº 21/97 Introduction of the Euro
DC nº 22/98 Transactions submitted to special taxes
DC nº 23/98 Reporting of different accounting entities of the same company
DC nº 24/98 Financial reporting of interests in joint ventures
DC nº 25/98 Leases
DC nº 26/99 Revenue

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United Kingdom

In the UK, merger and acquisition accounting are both permitted. These methods are stated in the national legislation and national standards. FRS 6 sets out the circumstances in which acquisition accounting and merger accounting are to be used. FRS 7 sets out the principles of accounting using the acquisition method. In addition, FRS 10, goodwill and intangible assets sets out the principles of accounting for goodwill and intangible assets. In the UK, merger accounting is only permitted by the Companies Act if the relevant shares in the undertaking acquired were acquired in return for the issue of equity shares by the parent or its subsidiaries, and the fair value of any other consideration did not exceed 10% of the nominal value of the equity shares issued. One of the five criteria set out in FRS 6 is that the consideration received by the equity shareholders of each party to the combination in respect of their equity shareholdings should comprise primarily equity shares in the combined entity. Any non-equity consideration (e.g. cash, other assets, loan stock and preference shares) should represent an immaterial proportion of the fair value of the consideration received by the equity shareholders of each party to the combination. FRS 6 also allows the use of merger accounting for certain group reconstructions.

Treatment of Goodwill DC No 12 – 92 Goodwill Concept

Definition of goodwill

Two approaches:

1. *Residuum approach*

Under this method, goodwill is taken to be the difference between the purchase price and the fair market value of an acquired company's assets.

2. *Excess profits approach*

Under this method, the present value of the projected future excess earnings over normal earnings for similar businesses is recorded as goodwill. Due to uncertainty of future earnings, valuing goodwill using this method is difficult.

Accounting treatment of goodwill

- **Capitalisation and amortisation method**

Companies valuing goodwill, follow the residuum approach to capitalise their assets. The net affect of this approach is that, the goodwill account also includes all other assets that are identifiable by the company. Thereby the goodwill account reflects an incorrect picture of intangible assets. One method of correcting this error is to use the 'Hidden Assets approach'. Under this method, the excess purchase price that companies pay over the fair market value of assets is for assets that are not shown or hidden from the balance sheet.

These hidden assets can be both tangible and as intangible in nature. They must be identified, recorded in the balance sheet and then amortised over their appropriate economic life. Then, the goodwill account reflects the true picture of only intangible assets.

Amortisation of recorded goodwill enables the company to match the cost of intangible assets with benefits from their use. The point of focus in this case is the period over which amortisation must take place. If the life of the asset is not determinable, as in the case of goodwill, amortisation of its value is done over a period of about 40 years. This will cause a minimal impact of writing off of goodwill on the annual net income.

- ***Capitalisation and no amortisation***

This method is most beneficial for a company. The company using this method gets to record the asset in the balance sheet instead of deducting it from owner's equity. As there is no amortisation, there is no yearly reduction of net income. The reason for such a treatment is that goodwill consisting of managerial ability, reputation and experience generally increases in value over time. This method views goodwill as an investment and hence it should stay on the balance sheet amortised.

- ***Write off method***

Under this method, goodwill is immediately written off against the equity stockholder's account, generally from retained earnings.

➢ In Portugal, there is the Decree-Law n. 238/91 July, 3 (Approving the rules for consolidated Accounts) and there is a standard that was released by the national standard body (Comissão de Normalização Contabilística). This standard is called "Accounting treatment of Business Combinations" while there is another one called "Accounting Concept of Goodwill". There are, also, other standards that refer indirectly to theses issues.

➢ In Portugal it is possible to use the pooling of interest method and the purchase method. These methods are applied according to specific conditions. The purchase method is applied under the basis that all acquisitions must be measured by fair value. The pooling of interest method has exceptional application and can only be adopted if some requirements are met, but in practice most of all companies follow this accounting treatment because of the advantages in the taxation system, namely article 62 of the Tax Law.

➢ To use the pooling of interest method, none of the companies can be identified as the purchaser, the basis of the transaction has to be the acquisition of shares by issue of shares and the total of assets and liabilities has to be aggregated in the new entity, besides other. The shareholders of each enterprise maintain substantially the same voting rights and interest in the combined entity.

Treatment in line with IAS

Effective 1st of January 2002, according to the FAS 142, goodwill is not amortised but subject to impairment test.

News and Notes
New IP Law comes into effect in Portugal

A new code governing intellectual property rights in Portugal came into effect 1 July 2003. The law aims to simplify and broaden certain aspects of intellectual property protection in Portugal.
With regard to trademarks, the law provides provisional protection for trademark applicants whose marks are undergoing or awaiting publication. It also allows for the rejection of a trademark application for using labeling similar to that used by a registered trademark. The new law also requires that a Declaration of Intention to Use be filed with the Portuguese Industrial Property Office every five years after registration or renewal.

The new regulations on goodwill according to the International Accounting Standards (IAS) make an accurate valuation necessary. Whereas entering goodwill on your balance suffices currently, in the near future an accurate valuation of all immaterial assets will be required.