Aspects Regarding IFRS’ Application to SMEs

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Abstract: On the enterprise level IFRS application to Small and Medium-Sized Entities (SMEs) is an issue of comparability and cost. On the other hand the development of a global accounting system involves the preservation of national finance-accounting practices. We propose an accounting system, which allows the small enterprise to choose between an IFRS for SMEs and the national accounting rules. Such an accounting system gives SMEs the possibility of promoting the company by using international standards the very moment they are ready for this endeavor. At the same time, such a system provides the global accounting systems with alternatives is a sample of the format of your full paper.

Key-Words: - International Financial Reports Standards, Small and Medium-Sized Entities, accounting practices

1 Introduction
The importance of financial reporting for non-rated companies is given by the enormous economic importance of SMEs in the EU. In februarie 2007, The International Accounting Standards Board (IASB) a publicat Exposure Draft of a Proposed IFRS for Small and Medium-sized Entities. The comment period for the Exposure Draft ended 30 November 2007. Staff has begun analyzing the comments and preparing recommendations to the Board. As follows we are trying to identify the problems regarding the comparability and the costs for adopting IFRS for SMEs by small businesses.

2 The Comparability
The main argument supporting the adopting of IFRS for SMEs is the need for comparability and for universality in terms of financial accounts. Comparability is hard enough to achieve at a national level, let alone internationally. Stephen A. Zeff [1] shows how enhancing comparability and convergence across borders may be difficult to achieve. It is well known that some countries, such as the US and even Britain, believe strongly in the superiority of their own accounting standards. Other differences make it difficult too: some countries use mostly capital markets for long term finance, and others use bank loans; valuation bases differ; and SMEs in different countries enjoy different facilities and face different fiscal policies that affect the way profit is described. There are different regulatory traditions. In the countries where the regulator has a greater influence on financial reporting, companies may be less willing to depart from a strict construction of IFRS for SMEs, because of the changes this imposes. Countries have, in the absence of an own accounting system, tried to adopt the international standards [2]. During 2000 – 2004, in Romania, the regulators did not succeed in imposing the international norms. The compliance with the international standards was in only, but did not translate into accounting practice and the quality of financial reporting remained unimproved. This demonstrates that it is not enough to have unique rules in order to provide comparability: if the accounting data is not comparable the benefit of implementing the new rules is not clear. In those countries where regulation is softer, companies may be more inclined to apply their own version of IFRS, taking into consideration the fact that the regulator would not object. Therefore, imposing (not by applying) a single accounting standard for all the national economies would accentuate the already existing differences between the countries regarding the level of economic entities. There are also differences regarding the way in which businesses are run: SMEs usually emphasize
a strategy of survival and stability, instead of maximization of profit that the rated companies focus on. Besides, financial reports of large companies in accordance with IFRS are aimed mainly at the current and future shareholders (only the ISC adhesion at the agency theory is known), whereas SMEs do not usually participate on the capital markets. If the public company shareholders are short-term owners, the SMEs owners are more stable, often getting involved in the company management. All these differences impact specific accounting practice and financial reporting. Perhaps the supporters of IFRS for SMEs consider that the comparability of financial reporting is achieved with the use of this standard by all the small enterprises. During the 50’s and 60’s another debate came up in the USA about whether uniformity or flexibility of accounting method better promoted comparability [1]. Since nobody firmly declared either of the parties as a winner, the standardization of the accounting methods did not occur. In our opinion, there must be some options available to make the differences inside enterprises visible.

Better comparability also leads gradually to convergence, that is to realizing the fourth goal of IASB: to bring about convergence of national accounting standards and International Accounting Standards and International Financial Reporting Standards to high quality solutions [3]. An impediment to the convergence is the interpretation of the international standards. In this issue, European accountants enjoy a fresh and remarkable experience: Since January 2005, the adoption of IFRS for rated entities was regulated in the EU. Sorensen and Kyle [4] show that when a user deals with statements drafted by foreign or transnational enterprises – even they believe that they have been drafted in accordance with IFRS, they should still be prepared to moderate its own expectations related to language, currency, accounting practices, methods, and policies, presentation techniques. Certain countries present things in a different manner. In order to understand financial reporting, users have to seek information regarding accounting practices; accounting terms can not be supposed to have the same meaning in all the countries [4]. Gregory S. Miller says that anyone looking to invest in another country needs to know something about the cultures of the country [4]. The importance of the interpretation of international standards is underlined by the creation of the International Reporting Interpretations Committee (IFRIC) – that proposes the official interpretations be approved by the IASBT and Committee of European Securities Regulators (CESR) – which analyzes the situation in each country. It is also possible that the meaning of a certain concept that was taken from the accounting tradition of a country and embedded in another country even if it was perfectly translated, may not be understood. Stephen A. Zeff [1] shows how even when words are understood concepts may not. Lisa Evans and others [5] show that there are conceptual differences in the underlying theory/philosophy between IFRSs and Continental European accounting, with regard to intended user groups, objectives and principles. Besides, it is known that IFRSs give rise to less objective balance sheet values and increase the scope for creative accounting, which render more difficult the comparability of information [6].

Nonetheless, the level of confidence in financial statements is increases as employees, managers, providers of loan finance, trade creditors and the Inland Revenue succeed in communicating in a unique language, which raises the information relevance. Certainly, the requests for comparability and the need of universality of the financial statements, despite being hard to realize, are real. Only in this way can bureaucratic barriers be crossed, access to financing across borders be achieved, suppliers evaluate the financial situation of foreign clients (foreigners), clients know the reliability of their partners, and foreign shareholders find out about the company. In the full process of globalization, accounting is part of the infrastructure and good communication can only be realized by the convergence of accounting languages. The issue resides in the fact that not all the SMEs have the needed resources to overcome all the obstacles mentioned above and to try to achieve the IASB's fourth goal. There are companies that need this “infrastructure” and are willing to pay for this, but this decision can only be made by the manager of the enterprise. This manager who is often the owner, knows best the moment when the company needs and affords to access a new quality level.

### 3 The Disproportionate Costs

The main argument against the uniform application of IFRS for SMEs refers to the disproportionate costs involved by double accounting relative to the needs and revenues of the smaller businesses [7]. Garbina and Bunea [2] show how the rated companies face large costs in the application of international regulations, especially in the form of informational investments and formation on various levels (general and financial, human resources,
judicial and commercial services). For SMEs the burden is that much bigger. And the investment even less worthwhile given the disinterest of foreign users, their scarcity, the low complexity of the economic – financial analyses, and the simple transactions carried out by the company [5]. Although IFRSs are subject to more frequent changes, thus permanently generating new costs, it is known that IFRS compliant financial statements do not serve the determination of taxed or distributed profit.

Determining taxable income requires special purpose financial statements—ones designed to comply with the tax laws and regulations in a particular jurisdiction. Similarly, an entity’s distributable income is defined by the laws and regulations of the country or other jurisdiction in which it is domiciled [3].

In fact, for most SMEs, the statutory financial statements, required by the regulator, satisfy some of the information needs and offer a certain degree of protection to the shareholders in the business contacts. Hutche [8] shows that the financial reporting based on the IFRS cannot lead to the decrease of costs or meet the needs of SMEs, as small enterprises have different information needs from larger ones. Some associate the cost of drawing up and publishing of the financial statements with the company’s useless exposure [9], [10], [7]. Moreover, the general perception is that the SME’s value is less important than their capacity to generate profit, with its liquidity and profitability [2].

Small enterprises, where the owners are often also managers, consider that revenue statements are a useful and sufficient source of information. But this state perception decreases with the growth of the enterprise and the evolution of the information system [11], [9]. Together with the development of the company, the disadvantage of high costs is gradually transformed into an advantage of the drawing up of financial statements in a language understood by most accounting information users who operate in a competitive market [12]. The subsequent development of a former small enterprise (business) and its evolution into a rated company on the stock market already involves the use of IFRSs for the drawing up of financial statements. There is a moment when the prior use of the Standard for SMEs becomes an obvious advantage. This is how this clear argument of the opposition of small companies towards the adopting of the FRSSE is transformed into a strong argument of large SMEs for the support of this standard. How many small companies become large companies is of uncertain and a matter of chance [13]. But small companies might not adopt the FRSSE because of the likelihood of the intention of growth [14].

It is certain that, although the urge towards managing a large company exists in each entrepreneur, small companies cannot be obliged to adopt the FRSSE just because of this possibility [14]. As the cost of adopting FRSSE is basically a promotion cost of the enterprise, we don’t see why its carrying out should not be left at the management’s decision. A very young “Alpha” company’s manager may consider it absolutely necessary to present the company in a universal language, for which reason he will adopt the FRSSE from the start. Whereas the manager of a “Beta” company—a large SME, which serves a local market, may not to see the necessity of this additional cost. Even if we take into consideration the subsequent development of the Beta company, its listing on the stock market and implicitly the necessity of passing to the IFRS, it is not democratic to impose on the company the timing for the incurrence of costs (of the adopting the FRSSE), just as it is not democratic to impose on the company the incurrence itself of such costs. And who can know in advance which companies shall prosper and need IFRS?

3 The Necessity of Accounting Practices Preservation

Speaking about the FRSSE, we must also keep in view the fact that the application of this norm presupposes the diminution of the differences between the accounting practices all over the world. This even where experience proves that it is exactly on the basis of accounting practices that the American and British regulations were developed, and which are recognised today as being superior to the international ones. The coexistence of national practices offers different solutions to the new problems that arise; it creates the possibility of obtaining answers in due time to the requirements of the equity market; it allows the identification, trying-out and implementing of new means of financial communication; and creates the premises of competitive accounting systems which may contribute to the removal of political influences. Feleaga [15], argues that for international standards a comparative approach between the national referent and the IASB one is necessary. Neag [16] shows that the preserving of national elements specific to the practices in the financial accounting field constitutes an opportunity, and IASB’s
perspective of standardization of European accounting pays too little attention to the possibility that accounting practices in different communities could offer the alternatives required by the evolution of the market. A total convergence of IFRSs with national accounting standards could lead to a limitation of options. If all the different reporting practices were eliminated, the subsequent application of the FRSSE in different economies will have different effects. Thus different accounting requirements arise, which gradually lead to … specific accounting practices. Haller [7], considers that the delegation of rule-making by the legislator to a private sector international organization may give rise to constitutional concerns. If we regard the FRSSE as a component of the future global standards, we must have in view the opinion of some states that are recalcitrant in offering more power to the global standards, considering that this will decrease the authority to set country-specific rules for tax accounting [17].

4 The Financial Statements Users
Asking ourselves whom the financial statements drawn up by SME according to the IFRS serve, several answers are outlined. IASB names seven plus one categories of users, Evans et al. [5] identified only five groups of users (employees, managers, providers of loan finance, trade creditors and the Inland Revenue), and Paolini and Demartini [18], focus on two fractions of users.

One unnamed beneficiary of the adopting by the SME of the international norms is represented exactly by the listed enterprises. Often, in their evolution, large companies purchase SMEs in full development. The presentation of the prosperous small business in a known language meets the needs of any assessor. One might say that for the small entrepreneur, this is an opportunity offered by the market, if we didn’t have a last curiosity: what’s the reason for the purchasing of the small business by the listed enterprise?

Behind the adoption or the reluctance to adopt the IFRS for SMEs by the European Union, there is, on the one hand, the dissipated force of accountants and managers – owners of the SMEs, and on the other hand, IASB’s organized activity. Users are weakly represented at the level of IASB and this is why they cannot make their points of view correctly understood in the establishing of the rules. For now, IASB is doing its homework thoroughly, preparing the grounds for the acceptance of its norm at the European level.

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The Commission for Judicial Affairs of the European Parliament has noticed the more and more theoretical character of IASB drafts, which actually have become so complex and theoretical, that SMEs, particularly, cannot follow them; at the same time it is questionable whether IFRS draft for SMEs adequately reflects the needs of SMEs and the variety of modes and sizes in which they operate; it also regrets that the IFRS draft for SMEs doesn’t take adequate account of the specifics of these enterprises where the accounts’ addressees are not anonymous investors more interested in short term investments as its is the case of public limited companies.

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Although it is trying to impose its norm with the help of the European Parliament, there is also the possibility for the IASB to convince each particular government of the advantages of the IFRS for SMEs. Of course, it is possible that at some time in the future, the standardization of accounting and of the removal of the last national financial accounting practice shall be achieved. It remains to be seen when this mirage shall be realized. If the implementation of the international standard for SMEs requires the approval of each particular government, it is likely that its universal acceptance will happen only when those who drew up the standard start to receive requests for specific standards for different groups of enterprises.

5 Conclusion
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Moreover even IASB admits that in practice, the benefits of applying accounting standards differ across reporting entities, depending primarily on the nature, number and information needs of the users of their financial statements [3]. After all the adoption of international rules is a unique and unequal way for promoting the company, therefore the transfer to international rules will be carried out. Leaving the option of adopting or not the IFRS for SMEs to the enterprise discretion, contradicts the competition principle – the main rule of globalization.

References: