

IFRS for SMEs in Europe – Lessons for a Possible Implementation in Romania

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Abstract: - The issue of International Financial Reporting Standards (IFRS) implementation is of a great interest for researchers, practitioners and regulatory bodies. The IFRS for Small and Medium-sized Entities (SMEs) was issued in July 2009 and currently strategies are needed for the implementation of this standard. The aim of this paper is to discuss the results obtained in Europe concerning the implementation of the IFRS for SMEs and the implications of a possible implementation in Romania. Comparing the national regulations with the IFRS for SMEs and integrating the results obtained through the literature review, the interviews we conducted and our own experience, we may advance some hypotheses about the Romanian state of affairs. We have identified the following as main difficulties associated with a possible implementation of the IFRS for SMEs in Romania: the extant emphasis on the conformity with tax regulations, the rule-based orientation, and the preference of accountants for prescriptive regulations.

Key-Words: - IFRS for SMEs, Romania, exploratory study

1 Introduction

Romania is on the way to ensure closeness with IFRS, even though conformity needs to be ensured with European Directives. The issue of IFRS implementation is of a great interest for researchers, practitioners and regulatory bodies worldwide. The IFRS for SMEs has generated a wave of discussions and contradicting results at the international level. Especially in the European Union (EU) there is a need for studies to guide the regulatory bodies in their decisions. In this context, the aim of this paper is to discuss the results obtained in Europe regarding the implementation of the IFRS for SMEs, and to discuss the implications of a possible implementation in Romania.

Given the reduced number of previous empirical or critical studies in this domain and the inexistence of any field testing concerning the IFRS for SMEs in Romania, our study is exploratory in nature; it intends to discuss the national and the international contexts associated with the IFRS for SMEs implementation.

After presenting the results of the extensive relevant literature review in section 2, we will describe the methodology in section 3; we will continue by analyzing the previous experiences of IFRS for SMEs implementation in Europe (section 4), and by deriving the implications for Romania (section 5). Finally, we discuss and draw some conclusions for the implementation of the IFRS for SMEs in Romania.

2 Literature review

There is enormous literature concerning the process of accounting harmonization and more recently, that of convergence [11, 17], dealing with such issues as the effects of IFRS on the relevance of the accounting information, the impact of culture on the IFRS implementation, the differences between IFRS and other accounting models, or the costs of IFRS implementation.

IFRS implementation is reported to result in increased comparability, transparency and quality of

financial reporting [22]. Significant impact on the companies' reported equity, increasing volatility of results and a diminishing conservativeness were also reported [10, 22]. The identified obstacles to IFRS were the strong accounting cultures, the differences between accounting systems and the important costs to eliminate them [10], the important role of taxation in some countries [11, 21]. Other authors [1, 2] argue that diversity will not disappear as it comes from different accounting cultures and their interpretation will be partly influenced by their history and previous practice.

In Europe, full International Financial Reporting Standards (IFRSs) are required for 7.000 listed companies while more than 7,000,000 unlisted small and medium-sized entities (SMEs) mostly follow national standards, thus not providing a satisfactory level of international comparability [10]. SMEs drive the European economy. Also, they are important jobs creators; they create an innovative environment and sustain competitiveness. Previous studies show that these entities have limited resources (which can affect the capacity to innovate) and have difficulties in obtaining capital. Generally, SMEs are defined via quantitative criteria (for example, in the EU a medium enterprise has less than 250 employees, turnover of less than 50 mil. EUR or a total balance sheet of less than 43 mil. EUR; in the United States of America, a medium business entity has less than 500 employees). The SMEs concept has different meanings in different countries. Because these entities may have anywhere from a few employees to a few hundreds, they do not form a homogeneous category. Also, there are variations concerning the users of the accounting information. Previous studies conducted in countries such as Czech Republic, Poland, France, Germany, Italy show that the main user is the State, followed by creditors [4, 5, 19, 20, 21, 22].

In order to increase the comparability and quality of accounting information provided by SMEs, the International Accounting Standards Board (IASB) began in 2003 a project aiming at developing an IFRS for SMEs, with the support of the EU and other regulatory bodies. IASB justified the need for this standard by the differences in circumstances of SMEs which can be different from those of larger entities, including such issues as: the users of the entity's financial statements and their information needs; the way financial statements are used; the depth and breadth of accounting expertise available to the entity; and SMEs' ability to bear the costs of following the same standards as the larger, publicly accountable entities (Basis for Conclusions for the Exposure Draft, par. 21). The new IFRS for SMEs was issued in July 2009 [9] and now strategies are needed for the implementation of this standard. The issued IFRS for SMEs [9] is a stand-alone

document, developed from full-IFRSs, but with several simplifications in order to be suitable for the needs of these enterprises and the cost-benefit relationship.

3 Research methodology

Being an exploratory study, we mainly use literature review (studies on the Romanian accounting system, and the European experience in applying the IFRS for SMEs), textual analysis of the standard and of national regulations, and qualitative data, gathered via means of interviews and our own experience. Some authors [15] show that exploratory studies enable researchers to develop hypotheses about the reasons for the existence of particular practices.

The interviews are the type of evidence most usually associated with case research [15]. It is important to emphasize that our selection of interviewees does not represent 'a sample' in regular statistical sense. They are not 'representative' statistically-speaking, but they are all involved in the decision-making process in their organizations. The interviews were carried out in Romanian, in order to capture the nuances, to allow a more fluent course of the discussion, and to ensure the consistency of interviews.

Personal experience was already used as a research method in previous studies. Some authors show that "Before we denigrate the validity of knowledge gained through prior working experience, we should remember that Foucault (1988) in his ground-breaking first book on the nature of psychiatry *Madness and Civilization*, used as his primary source of information knowledge gained from his time working as an intern at a French hospital".

4 The European experience in the IFRS for SMEs implementation

In some countries the possible effects or issues associated to IFRS for SMEs implementation were empirically studied, by regulatory bodies, accountancy firms, professional bodies or researchers. For example, a field-testing conducted in France by Mazars concludes that the application of the IFRS for SMEs in France is highly accepted. Another filed-testing is conducted still in France by the *Conseil National de la Comptabilite* (regulatory body); this study concludes thought that French SMEs do not need this standard. The contrasting results are explained through the population's dimension and the lack of representativeness (the results are not generalisable). This is only one case which underlines the need for a substantiated strategy for IFRS for SMEs implementation on solid empirical studies.

Several studies have been published which discuss various issues related to the implementation of the IFRS for SMEs in several countries. For example, some [16] argues that the IASB failed to determine the information needs of external users of SMEs financial statements. Others [cited in 1] consider that SMEs is a not a homogeneous category and identify three categories, arguing that the IFRS for SMEs is only suitable for one of them. A distinction between SMEs is made by Kirsch and Meth (2007) in a study [cited in 4] based on their size and users; they identify three categories of SMEs:

- smaller SMEs – managed by their owner and having banks as their main user – yet banks do not depend on the published financial statements since they have the power to demand and obtain information, and the financial statements have a feedback (verification) role;

- somewhat bigger SMEs - having some external shareholders who usually have the rights and power to receive internal information, and the financial statements have a feedback (verification) role;

- big SMEs with primarily external shareholders, which are dependent on receiving information with predictive value for making decisions.

Because of these differing needs of users, Kirsch and Meth conclude that restriction should be made in the scope of the IASB project to those SMEs whose capital providers have access to additional internal information, putting the emphasis on the reliability of the accounting information (rather than its predictive value, as is the case of full IFRSs).

Other authors [5] analyze via an empirical study conducted in Germany, the extent to which size is representative for the relevance of some accounting issues such as international exposure, the perception of preparers on the associated costs and benefits, but the results are ambiguous and the authors call for future studies. Because the previous results are not generalisable, are limited or contrasting, there is an important call for more empirical studies in this domain. More than this, each country is a specific domain concerning the characteristics of SMEs.

Regarding the cost/benefits relations, previous studies also show differing situations. Studies conducted in South Africa [cited in 18] confirm that the cost of compliance with IFRS exceed the benefits in the case of SMEs, while internationally, this has also been recognized in the United States of America and in the United Kingdom. Others [14] are concerned with the low level of literacy, lack of accounting education, and the absence of computerized accounting systems. Also, it is considered that smaller entities may incur relatively higher costs for complying with financial reporting requirements than larger companies [5].

These studies show different results in different settings. In some jurisdictions, full IFRSs are already used by all the entities [18], yet in other settings users prefer national regulations [4, 14]. Under these circumstances, Evans *et al.* (2005) [cited in 4] showed that: “We therefore recommended that, before progressing with this project, the Board should initiate in-depth research to determine to what extent the needs of owner-managers and other users of SME accounts differ between larger versus the smallest SMEs, and to what extent they may differ internationally. It may be the case that the needs of the smallest SMEs are best served by a system developed by national regulators, taking into account their specific economic environment.”

Previous studies in transitional countries show that even if some changes towards substance over form and a focus on investors have been tempted, the emphasis on compiling proper accounting records and on adhering to tax regulations rather than fairly presenting financial statements has continued in the Czech Republic [19, 20]; also, that considerable differences between the Polish regulations and IFRS were identified given the legalistic and rule-based orientation of Polish rules [21]. Moreover, problems associated with the lack of clarity in the fiscal law, a variable level of understanding of IFRSs by the regulators and preparers, the persistence of the communist mentality among accountants who gained their knowledge and skills prior the transition, the accountants’ preference for more prescriptive regulation and less choice of accounting treatments, were documented [21].

We may therefore argue that the differences between various approaches to IFRSs implementation and the resistance to change manifested in the developed countries are justified by their accounting culture, and are given by the orientation towards the State as the main user of financial information, the tax influence over the accounting system and the preference, given the mentality, of a rule-based set of regulations, in transition (ex-communist) countries.

Under these circumstances, differences exist between the national rules and IFRSs on one hand, and in the various approaches in which accounting rules are used.

4 The Romanian case

At the European level discusses emerged as to the necessity and opportunity of implementing the IFRS for SMEs in Europe [3]. In this context, studies on the Romanian case are needed.

At different points during its accounting reform, Romania also considered to benefit from IFRSs [8]: the implementation of an IAS-based system for large

companies through the Order of the Ministry of Public Finances (OMFP) no. 94/2001; the persistence of some IFRS elements in the OMFP 1752/2005, and even to a higher extent in the OMFP 3055/2009. For the IASB, full IFRSs are applicable for an important part of large companies, while the IFRS for SMEs may concern companies from both categories (large and SMEs). Under these circumstances, the OMFP 1752/2005 and more recently the OMFP 3055/2009 can be compared both with full IFRSs and the IFRS for SMEs in order to assess the degree of compatibility.

We acknowledge the fact that real accounting change is a slow process and the transferability of accounting concepts from one culture to another is controversial. Concerning the previous implementation of International Accounting Standards (IAS) in Romania, Țogoe (2003) [cited in 1] noted that there is “a local method, rather brief, of understanding and application of IASs”. On the other hand, Petre and Lazăr (2006) [cited in 1] consider that the regulation of accounting is not connected to taxation. In practice entities might use fiscal instead of accounting rules, but this pertains to practice and not regulation, as “there is no subordination of accounting to taxation and accounting rules are not harmonized with fiscal rules”, according with Petre and Lazăr (2006) [cited in 1]. They consider that “such an opinion that accounting serves fiscal interests represents at least not knowing the current Romanian reality”. However, other authors [6] found empirical evidence on the *de facto* level of fiscal influence over accounting (the sample comprised Romanian SMEs).

Comparing the Romanian accounting regulations [12, 13] and the IFRS for SMEs [9], and integrating the results obtained through the literature review, the interviews and our own experience, we may advance some hypotheses regarding the Romanian situation. First of all, we may say that even though *de jure* convergence is assured, the *de facto* convergence is not obvious, or in other words, even if the IFRS for SMEs is imposed, entities will in fact continue to use fiscal rules if they will not have either the means and/or the interest to apply it properly. This hypothesis is supported by Romania’s previous experience in applying IASs (in the period 1999 – 2005), by the experience of other countries in respect with the taxation interfering with accounting practice and IFRSs implementation, and by interviews that confirmed this situation.

Secondly, we advance that the IFRS for SMEs should be applied only by some (not all) SMEs. The IASB’s definition of SMEs does not make any reference to any size criteria, but the EU (of course including Romania, via the OMFP 3055/2009 for example) uses size criteria to classify entities. Previous studies shown that only some SMEs have external users of financial statements or an international activity; also, the interviews pointed

out that many Romanian SMEs have as the main user the State.

Thirdly, the application of the IFRS for SMEs will be difficult for accountants and for the entities. There is a need for a learning process [7] in order to support the implementation. Our interviews pointed out the Romanian accountants are oriented to the rules and to taxation issues.

5 Conclusion

This is an exploratory study on a subject of great interest nowadays, given the process of convergence assumed by the IASB and other standard setters. The interest of European bodies is to try to identify solutions for the harmonization of accounting practices across the EU and to increase the quality of the accounting information. In this case, studies are needed in every European country.

As far as Romania is concerned, the analysis of the current regulation vs. the IFRS for SMEs shows that there are several inconsistencies, both on conceptual and normative level. This is even more augmented by the Romanian accounting practice, where changes occur very slowly and where we obtained evidence supporting the lack of *de facto* application of some accounting principles or policies (especially those adopted from IFRSs, which in practice are treated in a fiscal approach).

Based on a literature review on other European countries, on interviews and on our experience, we identified some of the difficulties associated with a possible implementation of the IFRS for SMEs in Romania: the emphasis on conformity with tax regulations, the rule-based orientation and the preference of accountants for prescriptive regulations. Future empirical studies are needed to appreciate the magnitude of these effects.

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