The Option of Adopting the IFRS for SME at the European Union Level

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Abstract: Considering that at international level, standards developed by the International Accounting Standard Board (IASB) are irremediably imposed and that International Financial Reporting Standard for Small and Medium Enterprises (IFRS for SMEs) was built based on them, we think this accounting standard will always present a challenge for big unlisted enterprises. In this paper we argue the adoption of the IFRS for SMEs within the European accounting Directive as an option of the enterprise and not of the Member States.

*Key-Words:*IFRS for SMEs, EU, larges companies, administrative burden

1 Introduction

On 13 June 2000, the European Commission published its Communication on "EU Financial Reporting Strategy: the way forward" in which it was proposed that all publicly traded Community companies prepare their consolidated financial statements in accordance with one single set of accounting standards, namely International Financial Reporting Standards (IFRS), at the latest by 2005. International Financial Reporting Standards were issued by the International Accounting Standard Board (IASB). The Board considered that it is important for the competitiveness of Community capital markets to achieve convergence of the standards used in Europe for preparing financial statements, with international accounting standards that can be used globally, for cross-border transactions or listing anywhere in the world. Therefore, the aim was the efficient and cost-effective functioning of the capital market, the protection of investors and the maintenance of confidence in the financial markets, the freedom of movement of capital in the internal market and the support for Community companies in order to compete on an equal footing for financial resources available in the Community capital markets, as well as in world capital markets [1].

In July 2009, the IASB has published on its website the standard destined for unlisted entities: IFRS for SMEs. This standard was achieved by excluding parts inconsistent with small entities by simplifying accounting treatments set out in International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) developed for listed companies. Regarding its adoption at EU level, discussions were held in the accounting regulatory bodies, organizations of practitioners and academies. In these debates, financial reporting technical problems and problems regarding stakeholders and their needs have been most often raised.

In October 2011, European Commission published on its site the Proposal for a Directive of the European Parliament and of the Council on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings. The aim of this Proposal for Directive is to establish the requirement for unlisted companies to prepare financial statements and set minimum requirements in order to improve the EU-wide comparability of financial statements. This, in turn, should lead to a better functioning of the Single Market and, more concretely, an increased access to finance, reductions in the cost of capital and increased levels of cross-border trade, merger and acquisition activity. Overall, the proposal contributes to improving Europe's competitiveness through establishing a regulatory environment which encourages the growing and the creation of jobs. The proposal repeals the current Accounting Directives, replacing them and their subsequent amendments with a single new Directive [2].

Within the Proposal for Directive, the European Commission analyzed also the option of adopting the International Financial Reporting Standard for SMEs

(IFRS for SMEs) for mandatory use within the EU. Stakeholders, notably public authorities, were, however, divided on this idea and the Impact Assessment also concluded that introducing this new standard would not serve the objectives of simplification and reduction of administrative burden. Therefore, mandatory adoption of the IFRS for SMEs is not being pursued as a policy within this proposal.

The importance of financial reporting for unlisted companies is given by the enormous economic importance of Small and Medium Enterprises (SMEs) in the European Union (EU). According to the latest available data there are around 7.3 million companies within the scope of the 4th Directive on annual financial statements, companies which are unlisted [3].

In this paper, basing on the study made by the European Commission regarding the IFRS for SMEs, but also on other arguments, we'll try to demonstrate that big companies, unlisted yet, need, within the Directive of the European Parliament and of the Council on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, the option of adopting IFRS for SMEs to be regulated, this option to be at the discretion of the enterprises and not of the member states of the European Union. We continue this debate on IFRS for SMEs, because we believe that this accounting standard will present further interest especially for large enterprises which are not listed yet, but they will be.

2 Literature review

The main counterargument of uniformly applying the IFRS for SMEs refers to the disproportionate costs arisen from a double book-keeping in rapport with the needs and income of small businesses. Evans and collaborators (2007) [4] shows that even in Poland the least sophisticated way of financial reporting is perceived by many SMEs as a procedure consuming very much time. Gîrbină and Bunea (2007) [5] show how listed companies have high costs in applying international standards, especially in the form of informational investments and training at various levels (general and financial directions, human resources, legal and commercial services). Evans and collaborators (2007) believes that futility of this additional cost is given by low interest of external users, small group of the latter, the lower complexity of economic and financial analyses and outright transactions made by companies. Some managers associate the cost of preparation and publication of financial statements with the unnecessary exposure of the firm.

Although for small businesses, owners who are often managers believe that tax returns (not financial) are a useful and sufficient source of information, this state (utility) decreases with business increase and informational system evolution (Dugdale, 1998) [6]. With the development of the company, disadvantage of high costs gradually turns into an advantage of preparing financial statements in a language understood by most users of financial-accounting information acting on a competitive market (Keasey and Short, 1990) [7]. Further development of the former small firm and its passing to the category of publicly traded companies, already involves using IFRS for preparing financial reports, moment when the previous use of standard for SMEs becomes an obvious advantage.

In 2008, Tiron Tudor and Muțiu believed that regulation of financial reporting for SMEs is a national or regional issue for Europe, regulators having to decide whether to promote international standards [8].

3 Debate on IFRS for SME in the EU

In Commission Staff Working Paper Part I, Impact Assessment, Accompanying the document Proposal for a Directive of the European Parliament and the Council on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings they show that in 2010, in the European Union, there are around 7.345 thousands companies within the scope of the 4th Directive on annual financial statements. Among these, 5.937 thousands were microenterprises, 1.117 thousands were small companies, 245 thousands were medium sized companies and 45 thousands were large companies. All these companies face administrative burden as a result of obligations imposed by the Accounting Directives. Any company would incur some of these costs anyhow, for internal use or to provide the necessary information to its shareholders, business partners and other interested parties on its financial performance and position: these are the usual costs of business. Costs incurred only because of a legal obligation to provide information (without real business need to provide that information) constitute administrative burden. Administrative burden as a percentage of total administrative cost is highest for smaller companies. For unlisted companies, European Commission determined both administrative cost and administrative burden, presented in the Table no. 1.

Table 1 Annual administrative cost and burden per company from the Accounting Directives

Directive	Micro	Small	Medium - sized	Large
Administrative cost (€/company)	1.558	2.799	16.660	61.878
Administrative burden (€ / company)	1.169	1.555	4.290	0
Administrative burden (% of administrative costs)	75%	56%	26%	-

Note: regular bookkeeping costs are not included
Source: Commission Staff Working Paper Part I, Impact Assessment, Accompanying the document Proposal for a Directive of the European Parliament and the Council on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, [3]

The European Commission determined also the estimated total cost related to the requirements coming from the Accounting Directives stands at €19.4bn annually, half of which constitutes an administrative burden. Around 65% of the total costs and 90% of the total burden are incurred by micro and small companies. For medium-sized companies and for big companies the administrative burden is 1.1 billions euro and respectively 0.

We understand, therefore, that for the 45 thousands large companies, making financial statements in accordance with 4th Directive is not an administrative burden. During the development of the company, it appears the need for information in the financial statements to meet the requirements for several types of users. Gradually, the group of persons or the band who are interested in company the group of stakeholders expands. For small businesses, users of financial information are the administrator, the government with its institutions (for taxes) and 2-3 partners. Therefore, small businesses need and require simple financial statements, inexpensive and easy to be drawn up. However, the company’s growth determines the development of its relations with several categories of companies and institutions: potential investors, credit institutions, banks, suppliers, customers, the public. And many of these partners or potential partners are interested in various financial information. A company that wants to promote a competitive market is interested in providing financial information required by its partners or potential partners. Thus, a large company requires complex and costly financial statements, which meets the requirements of financial information market. The disadvantage of high costs of these complex financial statements gradually turns in the advantage of promoting business on a competitive market. In fact, by making financial statements meeting the requirements of the market, large companies improve their image, and the related costs may be considered advertising costs. Of course, we are talking about large companies, but which are not yet listed.

In addition, this category of enterprises begins to raise the problem of being listed on the stock exchange. In this situation, large unlisted companies find they need a common accounting language with that of the listed companies. It appears therefore, the need to use a conceptual framework common with that used by listed companies. Business presentation in a known language meets the desires of existing assessors in the market. In these circumstances, the use of IFRS for SMEs can be seen as a path to convergence, without claiming maximum harmonization and comparability. Using IFRS for SMEs by larges companies involves the use of common accounting principles with listed entities and the use of common definitions at least for assets, liabilities, equity, revenues, expenses and result.

The European Commission raised this problem also following the publication of the IFRS for SMEs in the summer of 2009, the Commission Services decided to seek the opinion of EU stakeholders on this Standard. During the four-months consultation period the Commission received responses from various stakeholders from almost all Member States and several pan-European organisations. The public consultation on the IFRS for SMEs took place between 17 November 2009 and 12 March 2010. The consultation document consisted of 12 questions gauging initial reactions to the Standard [9]. The Commission Services received 210 responses from 26 EU Member States (MS) and 4 non-EU countries. All responses are available on the European Commission website [10]. On the European Commission website there is presented also the Summary Report of the Responses Received to the Commission's Consultation on the IFRS for SMEs [11].

We shall refer further especially to 5 questions from the questionnaire sent to European Commission. They are questions noted with numbers 1, 4, 5, 6 and 8. The 5 questions enable the possibility to opt for one of three possible answers: Yes, No, Do not know. In addition, each question provides the ability to customize the responses, whether the respondent considers necessary.

Question 1. Do you think the IFRS for SMEs is suitable for widespread use within Europe? Among the answers received to this question, we consider only 172. The difference of 38 represents entities which didn’t answer or entities which answered I don’t know. Among the 172 respondents, 64 said yes, IFRS for SME is suitable

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to be used on large scale in Europe, and 108 respondents didn't agree with this affirmation.

Supporters of widespread use of IFRS for SMEs in Europe argued that the Standard is best suited for Large and Medium-sized companies, for international groups and subsidiaries of companies reporting under full IFRS as well as for companies active internationally, listed on non-regulated markets, seeking foreign financing or "non-publicly accountable" (as defined in the IFRS for SMEs). Enhanced harmonisation and comparability were mentioned amongst the main arguments in favour of the Standard. It was noted that a common accounting Standard can facilitate cross border trade, foreign mergers and acquisitions and international growth of companies. A universal accounting code was also seen as essential in attracting foreign investors and thus lowering the cost of capital.

Those opposed to IFRS for SMEs highlighted its complexity for SMEs, especially as regards the smallest companies. Opponents also questioned the actual benefits that the Standard could bring to companies operating only locally and having a limited number of shareholders.

Question 4. Does increased international comparability of accounts prepared under the IFRS for SMEs benefit users?

Only 130 answers can be considered for this question from the total of 210 answers received. We remark the very big number of entities who abstained from any answer: 80 (38%). From the 130 respondents, 12 answered I don't know, 56 didn't agree with this idea, and 62 said they considered increased international comparability of accounts prepared under the IFRS for SMEs benefit users. We show that among respondents, the majority of accountants and auditors (71%) gave an affirmative answer.

Respondents who answered positively consider the adoption of IFRS for SMEs would make it easier to analyse financial statements from other Member States, reducing potential mistakes and misunderstandings, would benefit overseas trading partners, investors and credit rating agencies.

Respondents who answered negatively consider it is still difficult, adding that the current level of comparability is sufficient. The need for international comparability was specifically questioned for companies operating only locally.

Question 5. Do you think adoption of the IFRS for SMEs should be provided for within the EU accounting legal framework?

At this question 170 respondents said Yes or No and 40 respondents didn't answer at all or said I don't know. 78 entities consider the adoption of the IFRS for SMEs should be provided for within the EU accounting legal framework, and 92 respondents don't agree with this option.

Supporters of adoption argued that it would increase harmonisation of the single market. Some noted necessary in order to ensure that IFRS for SMEs would remain in conformity with the Accounting Directives and allow potential future amendments. An interesting position is that showing it would be illogical to have a Member State option in the IAS regulation allowing all companies to adopt full EU IFRS, but not allow the adoption of the IFRS for SMEs, which is a standard specifically created for unlisted companies.

Some respondents mentioned IFRS for SMEs would bring no particular benefits especially to companies active only locally.

Question 6. If yes, should such an option be limited to a Member State option (i.e. that each Member States would have a possibility but no obligation to accept IFRS for SME)?

At this question there were 56 positive answers, 64 negative answers, and 3 respondents said I don't know. We remark that 41.4% of respondents (87), didn't fill any field referring to this question.

As shown in the Summary Report of the Responses Received to the Commission's Consultation on the IFRS for SMEs, the majority of respondents from 12 EU MS (AT, BG, CY, CZ, EE, HU, LT, MT, PT, SK, SL, UK) answered "Yes" while the majority of respondents from other 8 MS (BE, DE, DK, EL, ES, FR, IT, NL) answered "No" to this question. Public authorities from 12 MS were in favour and from 6 MS were against MS option [11].

The MS option was favoured as it would allow MS to choose appropriate size criteria for adoption, decide whether only consolidated or also individual financial statements could be prepared according to the IFRS for SMEs, etc. It would also provide a solution on the inter connection between accounting rules and tax laws in some MS.

Opponents claimed that in order to benefit from adoption of the IFRS for SMEs, a uniform and world-wide application would be necessary. Doing so the European framework of reporting would be broken. Some showed that companies, and not MS, are best suited to decide whether they would benefit from applying the IFRS for SMEs.

Question 8: Is there a case for giving companies, at EU level, an option to adopt the IFRS for SMEs?

Among those 210 answers received by the European Commission, 176 gave an answer to this question. Mostly these were positive, respectively 90 respondents (52% from 176) consider there is a case to give companies at EU level, an option to adopt IFRS for SME. We remark that among the groups of respondents, 68% of preparers consider the option mentioned in the question is valid.

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Supporters of the company option argued that companies are best placed to decide whether application of IFRS for SMEs standard would benefit them. It was pointed out that companies with international operations or those seeking foreign capital have a special case to use the Standard. Many commented that the IASB non-publicly accountable criteria for using the Standard is the most sensible application basis, and that size criteria are inappropriate.
Others pointed out that the company option would destroy harmonisation and comparability within the EU would diminish with an increased number of accounting frameworks, potentially causing confusion amongst users and therefore the MS ought to be those who decide on the use of IFRS for SMEs within their borders.
Therefore, in their answers to the public debate regarding IFRS for SME, achieved by the European Commission, preparers, users, accountants, auditors, public authorities and standard setters, presented arguments for and against this standard. Supporters of widespread use of IFRS for SMEs in Europe argued that the Standard is best suited for Large and Medium-sized companies. Taking into account this standard was achieved by excluding parts inconsistent with small entities or by simplifying accounting treatments set out in IFRS developed for listed companies, it would be illogical to have a Member State option in the IAS regulation allowing all companies to adopt full EU IFRS, but not allow the adoption of the IFRS for SMEs.
Regarding the adoption of the standard within the European Directive as an option of the Member States, some respondents said this proceeding would break the European reporting framework. Regarding the adoption of the standard within the framework of the European Directive as an option of the enterprise, supporters of the company option argued that companies are best placed to decide whether application of IFRS for SMEs standard would benefit them. Others pointed out that the company option would destroy harmonisation and comparability within the EU.

4 Conclusion

In this paper we tried to demonstrate that big companies which are not listed yet need, within the Directive of the European Parliament and the Council on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, the option of adoption of the IFRS for SME to be adopted and this option to be at the discretion of the enterprises and not of the Member States of EU.
In this respect, we showed that the option of the Commission of European Union to simplify the financial reporting cannot meet the requirements of all big unlisted enterprises. We showed that some enterprises in this category have in mind to be listed. Accordingly, the respective enterprises need a financial accounting language common with the other participants in the market and IFRS for SMEs constitute a viable option. We take into account here the fact that IFRS for SMEs was achieved based on full IFRS.
We presented further some of the positions referring to the adoption of the IFRS for SMEs stated within a public debate achieved by the European Commission. Overall, divergent opinions were expressed by respondents with regard to the potential application of the IFRS for SMEs in Europe. Many respondents commented that users of financial statements would benefit from widespread adoption of the Standard mainly due to an increased ability to analyse and compare financial statements prepared in different jurisdictions. Others reported potential benefits including expanded cross-border trade, more foreign merger and acquisition activity. Opponents to the application of IFRS for SMEs in Europe stressed the complexity of the Standard, especially for small companies. They feared that setup costs could outweigh potential benefits from the Standard. For enterprises that are active only locally there is little need for international comparability. Respondents from a majority of Member States considered that the IFRS for SMEs should be provided for in the EU accounting framework.
Referring to the adoption of the standard within the European Directive as an option of the enterprise, the number of those who agreed with this proposal is bigger than of the opposers. Supporters of this idea showed that the manager of the company knows the best the needs of promoting his company on a market of listed companies. Therewith, the manager of a big company knows also the financial possibilities of his company, if he afford or not to support the costs of adopting IFRS for SMEs. Therefore, the manager of a big company knows exactly the moment when the adoption of the IFRS for SMEs is convenient for the entity. In our view, we consider that although in October 2011, the European Commission published on their website the Proposal for a Directive of the European Parliament and of the Council on the annual financial statements, proposal in which IFRS for SMEs is not found, there will be further debates on this theme. The need of principles and of a common language on the financial market will raise discussions on adoption of the IFRS for SMEs.

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