

# **EXPERTS' OPINIONS ON THE USE OF INTERNATIONAL FINANCIAL REPORTING STANDARD FOR SMALL AND MEDIUM SIZED ENTITIES**

**Eva Hýblová**

Masaryk University, Faculty of Economics and Administration  
Lipová 41a, 60200 Brno, Czech Republic, e-mail: [hyblova@econ.muni.cz](mailto:hyblova@econ.muni.cz)

## **Introduction**

Small and medium-sized enterprises represent a significant sector of market economy; in the European Union, there are about 23 million small and medium-sized enterprises, employing 75 million people, and representing 99 % of all enterprises. (Information SME, 2008)

These types of enterprises usually do their accounting and create financial statements in compliance with particular national GAAP, which are based on different historical, legal and social foundations. The outcome is a differing information relevance of the data presented in the statements.

The differences in the information relevance of statements are becoming a serious drawback to international comparison of individual companies, which can prevent them from obtaining financial means or can present a problem in their communication with banks, shareholders, development institutions, contractors, rating agencies, etc.

In previous years the harmonization of accounting predominantly focused on large companies, registered at world stock exchanges<sup>14</sup>. Due to the growing significance of SMEs, the harmonization processes have also encompassed these entities for which the International Accounting Standards Board (hereinafter IASB) produced and published the International Financial Reporting Standard for Small and Medium-sized Entities. The acceptance of the project is supposed to be voluntary; however, IASB expects that the standard will gradually become world-wide accepted.

From the point of view of statement users, the implementation of the standard in the international context seems to be highly significant. From the point of view of statement producers, which means small and medium-sized enterprises, the process of implementing the standard can present a number of various problems.

An enterprise is considered to be small or medium-sized if it meets the criteria set in the Commission Recommendation (EC/280/96), as amended 1/1/2005<sup>15</sup>:

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<sup>14</sup> Since 2005, all businesses issuing securities at registered markets in EU member states have to use the International Financial Reporting Standards to produce both consolidated and non-consolidated financial statements.

<sup>15</sup> EC Commission. Communication from the Commission on a simplified business environment for companies in the areas of company law, accounting and auditing [online]. [cit. 2009-08-05]. Brussels: 2007. Available at:

- staff headcount,
- turnover,
- balance sheet total,
- autonomy.

The standard is supposed to harmonize small and medium-sized enterprises, which are in contrast to the European Commission Recommendation defined qualitatively<sup>16</sup>:

SMEs are entities that:

- do not have public accountability; and
- publish general purpose financial statements for external users.

Examples of external users include owners who are not involved in managing the business, existing and potential creditors, and credit rating agencies.

An entity has public accountability if:

- it files, or it is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; or
- it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance entity, securities broker/dealer, pension fund, mutual fund or investment banking entity.

The contents of the standard are as follows:

Preface	20 Provisions and Contingencies
1 Scope	21 Equity
2 Concepts and Pervasive Principles	22 Revenue
3 Financial Statement Presentation	23 Government Grants
4 Balance Sheet	24 Borrowing Costs
5 Income Statement	25 Share-based Payment
6 Statement of Changes in Equity and Statement of Income and Retained Earnings	26 Impairment of Non-financial Assets
7 Cash Flow Statement	27 Employee Benefits
8 Notes to the Financial Statements	28 Income Taxes
9 Consolidated and Separate Financial Statements	29 Financial Reporting in Hyperinflationary Economies
10 Accounting Policies, Estimates and Errors	30 Foreign Currency Translation
11 Financial Assets and Financial Liabilities	31 Segment Reporting
12 Inventories	32 Events after the End of the Reporting Period
13 Investments in Associates	33 Related Party Disclosures
14 Investments in Joint Ventures	34 Earnings per Share

[http://www.europarl.europa.eu/meetdocs/2004\\_2009/documents/com/com\\_com\(2007\)0394\\_/com\\_com\(2007\)0394\\_en.pdf](http://www.europarl.europa.eu/meetdocs/2004_2009/documents/com/com_com(2007)0394_/com_com(2007)0394_en.pdf)

<sup>16</sup> International Accounting Standards Board. International Financial Reporting Standard, IFRS for Small and Medium –sized Entities. London : 2009. ISBN 978-1-907026-16-4.

15 Investment Property	35 Specialised Industries
16 Property, Plant and Equipment	36 Discontinued Operations and Assets Held for Sale
17 Intangible Assets other than Goodwill	37 Interim Financial Reporting
18 Business Combinations and Goodwill	38 Transition to the IFRS for SMEs
19 Leases	

### **Expert opinions**

Within the research, also experts in the practice are consulted on particular issues, although currently, they are addressed only randomly because this is only an auxiliary criterion as also the number of respondents shows. All respondents have experience with the implementation of the full IFRS; they were asked several months before the standard for SMEs was published:

The question:

“What is your opinion on using the International Financial Reporting Standard for SMEs in practice?”

#### **Reply 1: Finance Manager of a medium-sized enterprise**

I have experience with using the IFRS in practice; mainly the transition from the national GAAP to the IFRS was demanding as it requires knowledgeable economic staff, modifications of software, etc. The question is what the international standard for SMEs will bring to specific businesses, what the differences in contrast to full IFRS will be. As it is a standard for small and medium-sized enterprises, it should be comprehensible; I expect it should be of smaller content than full IFRS and individual areas should be clearly defined. However, if the differences in contrast to full IFRS will be minimal, I cannot see any great benefit. Because some areas are reported on differently in compliance with international standards, it can have a great impact on the profit and loss of a trading company, the equity capital, division of profit, dividends. These facts have to be communicated to the owners and shareholders in advance. Further, there is the question of the corporate income tax. If the tax return remains to be based on the profit and loss as reported in compliance with Czech regulations, businesses will have to keep other accounts for the taxing purposes. This should be clarified and unified. All in all, I have to say that my experience with using the IFRS tells me that some areas are reported more precisely and truly than they were in compliance with the national GAAP.

#### **Reply 2: Auditor**

I perceive using the international financial reporting standard for small and medium-sized entities in the practice of the Czech Republic at the time being and near future as rather troublesome. For these companies, especially companies with one or several owners, accounting serves as a way to establish the optimum tax base to calculate the corporate income tax. This group of enterprises often uses accounting depreciations at the tax level, a depreciation plan in relation to the planned period of using long-lived assets and its updating is quite rare. Similarly, it is difficult to enforce rectifying items the creation of which is not a tax deductible expense on securing, maintaining and achieving profits. This shows that small and medium-sized enterprises do not even commonly use the basic

principles stipulated in the Act on accounting. Therefore, the implementation of the international financial reporting standard in the accounting procedures of these enterprises will demand enlightenment not only of accountants but also owners or managers of these companies.

### **Reply 3: Assistant auditor**

The standard could mainly help global corporations which are consolidating. Currently, individual financial statements are created in compliance with the local accounting standards and then reported in the required standards of the parent company, which is highly laborious from a client's perspective and for an auditor's inspection. Further, it leads to higher risk of potential errors. If there was the IFRS for Private Entities and its principles were used in the GAAP of individual states, these processes would be significantly simplified.

Another considerable advantage of its implementation and application would be better comparison of incomes and other indicators of financial analysis of small and medium-sized enterprises of individual countries.

What to remark in conclusion? As it is clear from the experts' opinions, the introduction of IFRS is a process that has to include not only accountants, but also managers, owners and the other employees of a company.

What problems are to be expected in relation to the implementation?

- The standard is extensive, it can be complicated and incomprehensible for many accountants, the process will be demanding as far as obtaining new information is concerned.
- SMEs have limited capacities for accounting, in the time of the transition the accountants will be overloaded with the current way of accounting and at the same time preparations for the transition.
- They will have to drop the current procedures based on the national GAAP, and start using a new way of thinking.
- It is not usual in smaller companies that the management and other employees get involved in accounting – it will be necessary to break the barriers in the understanding of the function of accounting.
- The entire process will be financially demanding; the financial burden can be excessive for small businesses.

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