

Reporting for SMEs: European Research Contributions

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Created 2004 (EAA Prague)

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Remit:

- to create a forum for European academics' contributions to regulatory processes
- to comment on existing and proposed standards developed by the IASB, and alert the IASB and EFRAG to research relevant to IASB proposals, or to the need for such research.

IASB due Process

1. Setting the agenda
2. Planning the Project
3. Developing and publishing the Discussion Paper (DP)
4. Developing and publishing the Exposure Draft (ED)
5. Developing and publishing the Standard
6. Procedures after an IFRS is issued

IASB's SME Project

Simplified IFRS, aimed at SMEs

Development:

- 2003 Survey of world standard setters
- 2004 Discussion Paper
- 2005 Staff Questionnaire, public round table meetings
- 2007 Exposure Draft, field testing
- 2008 further deliberations
- 2009 Standard published

EAA FRSC Contribution

- Comment on the IASB's Discussion Paper *Preliminary Views on Accounting Standards for Small and Medium-sized Entities* (Comment Letter CL72)
- Comment on the IASB's *Exposure Draft for an IFRS for SMEs* (Comment Letter CL125)

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Our Contribution

- Based on comprehensive surveys of prior (European) literature on reporting for SMEs
 - Empirical
 - Normative
 - Theoretical
- Limitation: accessibility of research in languages other than those spoken by the EAA FRSC or working group
- Changes in approach for 2nd contribution: co-opting experts (non-members of EAA FRSC): Jérôme Chevy, Maurision Cisi, Brigitte Eierle, Robin Jarvis

Comment on the Discussion Draft

- Within the EU, SMEs have considerable economic significance ...
- ... and are subject to reporting regimes which provide differing degrees of exemptions.
- SME financial statement user groups and their needs differ.
- Findings regarding the costs and benefits of reporting by SMEs are inconsistent.
- There is a considerable gap in existing research literature on the users and user needs of SMEs, and in particular the actual views and needs of owner-managers.

Comment on the Discussion Draft

- Arguments *for* differential reporting:
 - undue burdens and disproportionate costs
 - lack of relevance of statutory accounts to the main user groups
- Arguments *against* differential reporting are:
 - a demand for universality,
 - the need for comparability,
 - reliability
 - and the perception that statutory financial statements satisfy some information needs and provide some protection to stakeholders without access to inside information.

Comment on the Discussion Draft

- The IASB Framework's objective and concepts of financial reporting appear biased towards large entities with public accountability. For SME reporting, objectives, strategies and accountability relationships differ. A different conceptual framework may be required.
- The advantages of IFRS implementation cited in the literature are usually considered less convincing in the context of SMEs. Costs exceed benefits. Larger SMEs are more favourably disposed towards IFRS.
- An effective mechanism is required to ensure compliance, consistent application and enforcement of SME standards.

We recommended that:

- The IASB should develop a separate set of financial reporting standards for SMEs, but that a three-tier system may be required.
- Further research needed to determine to what extent the needs of owner-managers and other users of SME accounts differ internationally and between larger vs. the smallest SMEs.
- To satisfy cost–benefit considerations, modification not only of disclosure, but also of the recognition or measurement principles in IFRS might be required. Therefore, the standards for SMEs should not be based on the concepts and principles in the IASB Framework and existing standards.
- Neither size nor legal form seemed suitable indicators for the companies which should apply the IFRS for SMEs. Guidance and criteria should be suggested by the IASB, but EU input would be required to achieve convergence of regulation.

Comment on the Exposure Draft

Summarised prior literature on issues relating to (inter alia)

- Advantages of an IFRS for SMEs
- Definition of NPAAE/scope of the project
- Users and user needs
- Costs of implementation
- Fair value
- Compliance

Main issues arising from Literature:

- The ED does not define an adequate basis for modifying full IFRS, that is, it neither clearly states who the users are nor what the uses of SME financial statements are, nor does it explain how these differ from users and uses of full IFRS financial statements.
- The ED appears to treat SMEs and their financial statement users as homogenous groups. It claims to be suitable also for micro-entities, but its focus is on larger SMEs. The majority of (smaller) European SMEs and the information needs of many stakeholders are not addressed.
- Practical problems may arise for SMEs from a possible conflict between the EU's and the IASB's approaches to differential reporting.

Main issues arising from Literature:

- There is a concern that the Framework is not the best basis for developing an IFRS for SMEs.
- There are calls for greater simplification and more exemptions.
- There is still uncertainty about the relevance to users of the ED's fair value rules.
- The AAA FRSC 'is concerned that in the absence of a set of guiding principles, the IASB may be vulnerable to the lobbying of private constituents' (Botosan et al., 2006, p. 192).
- SME financial statement users and preparers are unlikely to lobby (Baskerville and Cordery, 2006).

Main issues arising from Literature:

- What effect is the current revision of the Framework likely to have?
- The IASB's board structure does not represent SME constituents.
- How will jurisdictions enforce the standard (given that many SMEs are exempt from the audit requirement)?
- If the IFRS for SMEs is of greatest relevance to developing economies, are these economies' needs and circumstances considered? The local institutions are carrying out field tests in a number of developing nations.
- Further research is also required (and should be commissioned by the IASB) after the introduction of the IFRS for SMEs.

Changes from ED to IFRS

Changes include:

- Making the IFRS a stand-alone document
- Eliminating most of the complex options
- Adding guidance on remaining options
- Omitting topics that typical SMEs are not likely to encounter
- Simplifying some complex requirements
- Not permitting a revaluation option for property, plant and equipment and for intangibles.
- Amortising all indefinite-life intangibles, including goodwill.
- Recognising as expenses all research and development costs.
- Recognising as expenses all borrowing costs.
- Simplifying the guidance for calculating impairment of goodwill.
- Simplifying the measurement of a defined benefit pension

Conclusion

- Many of the detailed, specific concerns have been considered and addressed
- Some of the more fundamental concerns remain
- More research is required on SME user needs and costs and benefits of implementation of the IFRS for MSEs and cost and benefits of different reporting models