Accounting for SMEs – How Important is Size in Choosing between Global and Local Standards?

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Abstract—There is limited evidence from various countries about the possible impact of various criteria to be used to determine the scope of the IFRS for SMEs issued in 2009 and, research is needed in this area. We provide evidence from Romania, an emerging economy member of the European Union. The aim of this paper is to analyze in a local setting if size is a relevant factor for deciding between local and global standards for SMEs. Our results indicate that size is a moderate indicator of the existence of possible users interested in financial statements and that there is a difference between the scopes of the standard determined on various criteria.. Also, we suggest that the international exposure is quite reduced in the case of SMEs, but is sufficient to suggest that at least some SMEs would benefit from international comparability of financial statements.

Keywords—SMEs, IFRS for SMEs, accounting regulation, entity's size.

I. Introduction

GLOBALIZATION drives the need for accounting harmonization/convergence between different accounting systems in various countries. Over the last years, the International Accounting Standard Board (IASB) gained legitimacy, its standards being accepted in many countries worldwide. An important step was the European Union's (EU) decision to impose full IFRS to entities listed on European capital markets starting 2005 [15]. But apart from these entities, SMEs continue to apply national standards which ensure a reduced degree of harmonization, thus not providing a satisfactory level of international comparability [9], [14], [21].

In order to increase the comparability and quality of accounting information provided by SMEs, IASB published in 2009 the IFRS for SMEs [10] and now various countries discuss strategies for the implementation of this standard. Several countries worldwide decided already on the adoption, while others still considering it [17]. The main question is which type of entities should or may be allowed to apply this

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standard. While the scope of the standard refers to entities producing general purpose financial statements, in many countries accounting regulations refer to size criteria. Existing academic literature on empirical tests for suitability of the IFRS for SMEs for all SMEs is inconsistent [4].

The aim of this paper is to analyze in a local setting if size is a relevant factor for deciding between local and global standards. We analyze the characteristics of SMEs (size, users and international exposure) in order to propose a typology based on which regulators might base their decision.

We find that size is a moderate indicator of the existence of users and that using size as a criterion to set the scope of the standard, some SMEs would fall out of the scope, while the standard might be beneficial for them, while others will have to incur the cost without having direct benefits.

Our results are important for the emerging literature on the IFRS for SMEs implementation in various countries, but also for regulatory analyses. The general context of SMEs should be understood before regulators decide what type of accounting model these entities should follow. Additional research is needed in this area.

The remainder of this paper is organized as follows. A literature review presents the main results of various criteria used in order to establish the scope of the IFRS for SMEs. The methodology section describes how data was collected and analyzed. The next section presents the results analysis, while conclusions and further research ends the paper.

II. Literature Review

While larger listed entities benefited from academic research in the last decades, SMEs gained only recently more attention. These entities are connected to the local environment and generally do not form homogeneous groups. In terms of employment, they range from zero to 250 employees (and in some jurisdictions even more). They might have different types of exposure to international business environment, and variations in terms of risk, competitiveness and profitability. Also, in some SMEs there is a reduced number of stakeholders (mainly the owner, the State as tax collector and the business partners), while others have more stakeholders (including a separation between owners and managers, lenders etc.).

In terms of accounting, SMEs are mainly concerned with legal requirements, lack accounting literacy and use few accounting techniques [18]. However, there are variations

between SMEs because of their differences in resources, stakeholders, competencies and strategies.

SMEs were until recently neglected because of their local orientation. Because their activity is mainly local, they were required to apply local standards. However, globalization of economies leads to a need for harmonization, even for SMEs. One example is the European Directives [16], but they are transposed in national rules which do not lead to a high degree of international comparability [9], [14], [21].

Therefore, several countries started to become interested in applying the IFRS for SMEs [17]. However, the application of this standard is needed only for some SMEs, and the literature about the suitability for SMEs and the opinion of various stakeholders is emerging [2], [3], [4], [8], [13], [14], [19].

Eierle and Haller [4] consider, after conducting a literature review, that size is a proxy for the importance of an entity within its economic and social environment, and a proxy for the amount of shareholders who do not participate in management. They consider that as size increases, higher levels of responsibility, transparency and strictness in accounting, auditing and publication rules manifest, to reduce agency conflicts. Using a sample of German SMEs, they find that there are significant differences between smaller and larger SMEs terms of relevance of international activities and involvement of owners in management, and suggest that with increasing size there are changes in the business model.

Paoloni (cited in [3]) suggests a taxonomy based on size and the firm's market (national vs. international), and considers that it is also useful to distinguish SMEs on the basis of attitude towards external disclosure, on the administrative and accountancy competences, on the number of external stakeholders and their information needs.

Another distinction is made by Kirsch and Meth (cited in [3]) between SMEs based on their size and users, identifying three categories of SMEs:

- smaller SMEs – managed by their owner and having banks as their main user – yet banks do not depend on published financial statements since they have the power to demand and obtain information, and financial statements merely have a feedback (verification) role;
- somewhat bigger SMEs – with some external shareholders who usually have the rights and power to receive internal information, and financial statements mainly have a feedback (verification) role;
- big SMEs – with primarily external shareholders who depend on receiving financial statements information with predictive value for making decisions.

These studies give different results in different settings. The main characteristics of SMEs that are important for the accounting model seem to be the entities' size, number of owners, users of the accounting information, the entities' international exposure, but also the competences of the accounting profession and the business complexity and growth.

The main question is how these features should influence the choice of accounting models. In the European Union the accounting requirements are based on size, with a distinction between large, listed entities and SMEs. In some cases a three-tier approach is used or envisaged [7]. On the other hand, the traditional Anglo-Saxon and especially American principle is that users, and especially the type and complexity of finance arrangements have a significant impact on the accounting model [16].

The IFRS for SMEs is intended for entities that: "do not have public accountability, and publish general purpose financial statements for external users" [10], [11]. More than that, the IASB [11], [12] insists that "size is no barrier". Also, it insists that the financial statements produced for the use of owners-managers only for reporting taxable profit likely are not general purpose financial statements. Therefore, in this view, the existence of users triggers the mechanism of preparing general purpose financial statements and therefore the need to apply the IFRS for SMEs. On the other hand, the professional literature asks the question "How big is small" [7] in order to find out if size can be used in deciding the application of the standard, because applying it would imply higher costs for SMEs.

In many EU countries, financial reporting is linked to taxation [16], which is inconsistent with IASB's philosophy and raises issues for an accurate IFRSs application, and especially that of the IFRS for SMEs. The application of the IFRS for SMEs will imply breaking the traditional bond between the financial statements and the income tax return [14], which will increase the costs of application. Since larger SMEs have more resources and more users, some consider that only they should consider applying the standard.

The relationship with taxation is important to be considered because of two reasons: implications for costs are obvious, and the accounting figures are the starting point for the calculation of the taxable profit. The implementation of the IFRS for SMEs leads to the following situations: if the standard is considered to be the starting point for taxation, a difference will appear between the entities applying the standard and those applying national rules. On the other hand, if other accounting rules should be applied, the IFRS for SMEs will represent an additional obligation for entities, even higher costs of application and the tax approach might be kept under IFRS treatments.

A significant part of the existent literature shows that SMEs are not a homogeneous group from this point of view, and that only some SMEs will benefit from the standard's application [3], [19]. On the other hand, Eierle and Haller [4] do not find that size has influence on the assessment of costs and benefits related to standards application.

The question resulting from these gaps in literature is: how relevant is size for the existence and the number of users? In addressing this question, we report on the major issue of determining the scope of the standard based on size or on the existence of users.

III. RESEARCH METHODOLOGY

We conduct our empirical study in Romania, a member of the European Union. Like in other EU countries, SMEs represent the overwhelming majority of entities (99.6%), while they employ only 63% of the work force and generate approximately half of the national value added [6]. Recently, the EU issued the "Think Small First" "Small Business Act" [5], intended to increase Europe's capacity 'to build on the growth and innovation potential of SMEs' (p. 2), thus continuing to focus on its 'backbone of the European economy' (European charter for small enterprises).

EU's strategy for better regulation is crucial for SMEs, which will allegedly greatly benefit from the modernization and simplification of existing EU legislation and from the ambitious programme to reduce administrative burdens arising from EU legislation by 25% by 2012; yet, the EU needs to take further significant measures to release the full potential of SMEs, as in general EU SMEs still enjoy lower productivity and grow more slowly than their counterparts in the US [5].

Romania has an accounting system traditionally linked to taxation, but IFRS-based financial statements are considered to be more useful for users [1], [2]. Accounting standards and requirement are a part of the infrastructure that might help the economic development of these entities or can stop it if they are considered as a cost. In this context, conducting research on SMEs in an EU country is important.

A questionnaire has been sent by email to professional accountants working in SMEs. 145 questionnaires were received, but 19 were discarded because they were incomplete. 126 usable questionnaires were employed in our analyses. XLSTAT is used for data analysis. Table I reports on the size of entities in our sample:

TABLE I
THE SAMPLE CHARACTERIZATION BASED ON NUMBER OF EMPLOYEES

Number of employees	%
< 10 employees	34.9
10-50 employees	38.05
50-100 employees	18.25
100-250 employees	8.7

We conduct our analysis using descriptive statistics and cluster analysis. The cluster analysis techniques allow the identification of more homogeneous subgroups in a less homogeneous group. We have therefore performed agglomerative hierarchical clustering (AHC), a technique that does not require the specification of any number of clusters; it starts with the points as individual clusters and, at each step, merges the closest pair of clusters [20].

IV. RESULTS ANALYSIS

Based on the literature review, we derived that two main factors might influential in determining the scope of the IFRS for SMEs: size (which is commonly used in the European Union to determine the accounting requirements for an entity) and the existence and types of users (which forms the manner

in which the scope of the IFRS for SMEs is set). Besides that, the international exposure in another factor discussed in relation with the possible adoption, given that international standards were conceived to increase the international visibility.

Table I presents the results in terms of employees, but we continued the analysis with the identification of clusters based on three measures for size: number of employees, total assets and turnover. Table II presents results.

TABLE II
CLUSTERS BY SIZE

Class		Central objects			
	Sequence number	1. Turnover (EUR)	2. Balance sheet (EUR)	3. No employees	No. of observations
1	Obs3	100,000- 500,000	100,000- 500,000	< 10	56
2	Obs30	10 mil – 50 mil.	10 mil – 50 mil.	100 – 250	45
3	Obs37	500,000 – 1 mil.	500,000 – 1 mil.	10 – 50	25

As one can note from Table II, most entities (44.4%) in our sample employ less than 10 employees, and have both total turnover and balance sheet totals of between 100,000 and 500,000 EUR, thus being microenterprises as per European criteria (European Commission, 2003). 25 more entities employ between 10 and 50 employees, and have their turnover and balance sheet total falling between 500,000 and 1 million EUR. Our sample is thus representative for the European reality, with 64% of entities being micro and small entities.

We also investigated the users of financial statements prepared by SMEs. Table III reports the results.

TABLE III
THE EXISTENCE OF USERS

Users	No (%)	Yes (%)
Tax authority	15.1	84.9
Creditors	40.5	59.5
Customers	59.5	40.5
Suppliers	49.2	50.8
Analysts	80.0	20.0
Managers	6.3	93.7
Owners	5.6	94.4
Competitors	73.0	27.0
Employees	81.7	18.3
Press	81.0	19.0
Public	69.8	30.2
Others	89.7	10.3

We have further asked respondents to indicate the users they perceive to have for the information published in their general-purpose financial statements. In this respect, we can note two interesting results. First, an overwhelming proportion of the entities in our sample perceive the State (through its tax authority, 84.9% of the answers) and internal users (managers and owners, in proportions of 93.7% and 94.4% respectively) to be the users of such information. Second, most entities in our sample do not have analysts (80%), competitors (73%),

employees (81.7%), the press (81%) or the public (69.8%) as users of the information published in their financial statements. To us these results are clear indications of a concentration of financial reporting information published by Romanian SMEs towards the needs of the State and of internal users.

Users are a key element in financial reporting, as they have been reported to influence the way financial statements are prepared and the way regulations are conceived and enforced. We wanted therefore to typify the entities in our sample as per the importance of their users. We have thus performed agglomerative hierarchical clustering, and four clusters resulted, but the explanatory power of the groups was quite low. Therefore, we have visually inspected the data and observed two main patterns: one in which entities have only three users (the State through its tax authority, the managers and the owners), and the other in which entities have more users, more informed and more demanding. Therefore, we have performed k-means clustering forcing two clusters, and results confirm our assertions (see Table IV).

TABLE IV
K-MEANS CLUSTERS BY THE USERS OF FINANCIAL STATEMENTS INFORMATION

Class	Sequence number	Users	No. of observations
		Central objects	
1	Obs1	Tax authority, managers, owners	66
2	Obs45	Tax authority, creditors, customers, suppliers, managers, owners, competitors, public	60

Approximately half of the entities (66 to be precise) have only three users (class 1), that are less demanding and mainly interested in checking the tax correctness (the State) and in understanding the overall financial position and performance of the business (managers and owners). The others (60 entities) have among their users the creditors, customers, suppliers, competitors and even the public, thus being more interested in presenting better quality financial statements.

The next step is to analyze the correlation between the clusters on size and the clusters on users. In order to obtain only two groups based on size, we regrouped the entities as large and medium SMEs group (70 entities) and micro entities (56 entities). It results the following analysis:

TABLE V
CLUSTERS BY SIZE AND BY USERS COMPARISON

Users /Size	Larger SMEs	Microentities	Total
Cluster 1- Tax authority, managers, owners	20	46	66
Cluster 2 - Tax authority, creditors, customers, suppliers, managers, owners, competitors, public	50	10	60
Total	70	56	126

These results suggest that size is only a rough approximation of the existence of users. There are larger entities without users (28.57%), and also there are smaller SMEs with users (17.85%).

Besides size and users, prior literature discusses also the local or international activity as a factor probably influencing the suitability of the IFRS for SMEs for specific entities (Paoloni cited in [3]). We analyzed the international exposure of the SMEs in our sample.

TABLE VI
THE INTERNATIONAL EXPOSURE IN THE SAMPLE

Geographical coverage	%
Locally only (city, county)	34.1
Regionally	13.5
Nation-wide	17.5
Predominantly nation-wide	12.7
Predominantly international	15.9
International only	6.3

Table VI reports that 47.6% of SMEs have a local and regional activity, 12.7% have a nation-wide activity and only 22.2% have international exposure.

Concluding on our analysis, it is obvious that the use of one of these three criteria (size, users and international exposure) to establish the scope of the standard leads to different results. For example, based on size 19.84% (large SMEs) or 55.55% (larger SMEs) of SMEs should apply the standard, based on users 47.62%, and based on international exposure 22.22%. Based on size and users existence, 50 SMEs (39.68%) would fall under the scope of the standard. While arguments supporting or rejecting these criteria might be found, as the literature review indicated, our results suggest a great variety in the number and type of SMEs which might be affected by the implementation of the IFRS for SMEs.

V. CONCLUSION AND IMPLICATIONS

The IFRS for SMEs is proposed to increase the comparability and quality of SMEs financial reporting. While some countries adopted or planned to adopt the standard, others are still debating about the suitability of the standard to the needs of their economy and especially about how to determine the scope of the standard [17]. In this discussion, three main ideas emerged: to use the size of the entity, to use the existence of users as the reason for financial reporting, and the international exposure [3], [4], [18], [19].

While there are only a few studies providing evidence from various countries about the possible impact of these criteria under the scope of the standard [3], [4], research is needed in this area. We provide evidence from Romania, an emerging economy member of the European Union. Our results indicate that size is a moderate indicator of the existence of possible users interested in financial statements. Also, we suggest that the international exposure is quite reduced in the case of SMEs, but is sufficient to suggest that at least some SMEs would benefit from international comparability of financial statements.

Using cluster analysis which led to the identification of groups based on these criteria, we provide evidence that there is a difference between the scopes of the standard determined on various criteria. Therefore, we suggest that irrespective of the criterion used, some SMEs would fall out of the scope, while the standard might be beneficial for them, while others will have to incur the cost without having direct benefits. As such, the most obvious criterion to be used in Romania is size, and based on this 19.84% (if only large SMEs) or 55.55% (if all larger SMEs) of SMEs should apply the standard. However, only 71.43% of these entities have users, and therefore 28.57% of these entities would be required to use the standard without an obvious use.

On the other hand, 10 SMEs (which represent 14.28% of the sample required to use the standard) have users, but would be left outside the scope of the standard because they are smaller SMEs. The use of the two criteria (size and users) will lead to 39.68% of the SMEs in our sample to be required to apply the IFRS for SMEs, which is an important share. However, the impact of the possible implementation should be investigated, and also the need for this standard, in terms of users and preparers perception, the political objectives of the economy, the strategy of regulators and professional bodies. All of these factors influence the decision to adopt a standard and its further application and research in this area is needed, in various countries.

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