

# IFRS for SMEs IS small, small ENOUGH?

**T**o the relief of many accountants and their clients, the International Accounting Standards Board (IASB) is moving closer and closer to issuing the International Financial Reporting Standard for Small and Medium-Sized Entities (IFRS for SMEs). However, with the final standard still several months (or perhaps years) away, a potential shortfall has already been identified; will the proposed IFRS for SMEs be suitable for the smaller entities within the spectrum of small and medium enterprises? This question has been raised in an International Federation of Accountants (IFAC) information paper entitled, "Micro-entity Financial Reporting: Perspectives of Preparers and Users" (the Report). IFAC suggests that these smaller entities or "micro-entities" may have information needs that are more restricted than those of other small and medium enterprises, and compliance with full IFRS or proposed IFRS for SMEs may continue to be to burdensome.

## Small or micro?

IFAC has tentatively defined a micro-entity as an entity having less than 10 employees. IFAC does, however, concede that obtaining an exact definition cannot be based merely on quantity but also on several qualitative factors, such as public accountability. Additional research in this area has been encouraged by IFAC.

The report suggests that the preparers of micro-entities' financial statements are the owner-managers of the entities themselves, bookkeepers or hired accountants. The owner-managers tend to have very limited accounting and financial knowledge, and place reliance on external accountants to provide financial advice as well as prepare the financial statements. These financial statements generally consist of a balance sheet and an income statement, prepared based on the accrual principle. The authors of the report suggest that much of the published literature on which the report is based is restricted to studies conducted in developed countries, and does not reflect the very different environment in which micro-entities operate in developing, emerging or transition economies.

## User concerns

Full IFRS and the proposed IFRS for SMEs is based on the Conceptual Framework, which identifies the following key users of general purpose financial statements; investors, lenders, suppliers, employees, customers and government. IFAC's report has suggested that this range of users is more extensive than the reality of a micro-entity. Users of micro-entity financial reports generally comprise of only three interested parties, the owner, financial institutions and tax authorities.

The report suggests that, despite the limited number of users, the significance of SMEs in the global economy has been, and still is, increasing. Several countries have grasped the job creation opportunities and other potential benefits of the SME, and are encouraging the sector's growth through decreased regulation. South Africa for example has legislated special Income Tax Provisions for SMEs, including the much published small business tax amnesty programme.

Not unexpectedly, the report has suggested that the main concern of the owners of SMEs is the cost of producing financial statements, of which, in any event they tend to understand very little. The owners generally feel that the financial function is merely an inconvenience to them, in addition to having strong confidentiality issues.

IFAC suggests that, despite regulation of SMEs becoming less and less burdensome, the accounting requirements (based on full IFRS compliance) have increased. The IASB's solution has been the IFRS for SMEs project. IFAC queries whether the proposed IFRS for SMEs will meet the information-needs of the users of micro-entities' financial reports, especially when considering the cost-benefit ratio of the production of financial information for micro-entities.

## Conclusion

The IFAC report is giving a voice to those smaller entities in the economy, and the unnecessary burden placed upon them by IFRS, whether full IFRS or the proposed IFRS for SMEs. The authors of the report indicate that

significant research needs to be conducted worldwide to identify exactly what the users need are in respect of micro-entities' financial reports. IFAC intends to use the report as a basis for responding to the release of the exposure draft by the IASB of the IFRS for SMEs, with a focus on the preparers, and user information-needs of micro-entity financial reports.

Of particular concern to IFAC is less developed economies in which low literacy levels, lack of accounting education and absence of computerised accounting systems, amongst other things, may be further impairing the ability of such entities to produce fairly presented financial information in accordance with IFRS. South Africa is in the relatively unique position of having SMEs operating in a more developed economy and other SMEs operating in a developing economy. Surely this places us in the ideal position to assist in the establishment of meaningful IFRS for micro-entities. As was succinctly stated by Sue Ludolph, SAICA Project Director - Accounting (in ASA June 2006), "Without you, how will the standard setters ever be able to move reality from their ivory towers?" [ASA](#)

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**Design, Layout & Reproduction**

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Member of the Audit Bureau of Circulation  
ABC for the period Jul to Dec 2006 at 39 352

Member of the  
Magazine Publishers Association  
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Supplied gratis to Chartered Accountants (SA), Associate General Accountants  
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02587254 SAICA Reg No. 020-050-NPO SAICA VAT Reg No. 4570104366

## this months contributors...



**Andrew Abdo and Greg Fisher** write on the link between good corporate governance and shareholder value. Their research is based on the interest they have in defining and understanding world class companies and the search for shareholder value. The recent corporate scandals have once again highlighted the need for effective governance in the upper leadership ranks of a business that wishes to be sustainable and competitive over the long-term. It is interesting and useful to consider the impact of corporate governance practices on the creation of shareholder value. Their article is an adaptation of formal academic research conducted by the authors for the Gordon Institute of Business Science.



**Vincent Faris** is a former partner at Price Waterhouse, and has been involved with the legal profession for many years acting as a forensic accountant for the Law Society of the Northern Province. He is also involved in the education and training of both Candidate Attorneys and practicing Attorneys by presenting lectures, seminars, courses and the like on behalf of both the national and provincial Law Societies.



**James Sey** writes about South Africa's CEOs and their views on globalisation, and their policies and thinking on supply chain reform and effectiveness. In his view, it is very important that other senior executives, especially financial directors, become more active in supply chain strategy in order to understand how important supply chains are in the new global economy.



**Dr Roger Sinclair** writes on the unlikely marriage between marketing and accounting in fair Value. Dr Sinclair has a PhD from Wits where for five years he was head of the department of marketing. He is now Professor Emeritus and is managing director of BrandMetrics a brand valuation company.



**Colin Sutherland** writes on IAS and IFRS in Europe. He is an independent international consultant. After "retiring" from the profession in France in 1991, he has worked on contract for the European Union, the World Bank and the United Nations, in Eastern Europe, the former Soviet Union, the far East and Sub-Sahara Africa. He is presently running between Hanoi and Moscow.



**Stephen Coetzee** is a senior lecturer at the University of Pretoria and specialises in Financial Accounting. He has completed his masters degree in taxation and has a keen interest in accounting education. Having completed his articles at a medium firm, issues affecting small and medium firms are close to his heart.



**Ilse French and Quinton Greyling** write on Insurance Contracts. Ilse is a director in the Financial Services Practice of PricewaterhouseCoopers in Johannesburg. She is a member of the PwC Global IFRS Insurance technical committee. Quinton is a Fellow of the Faculty of Actuaries and an associate director in the Actuarial and Insurance Management Solutions Practice of PricewaterhouseCoopers. His areas of interest lie in insurance company's shareholder value measurement and specifically how current developments in insurance accounting will affect the manner in which actuaries value insurance contract liabilities for published, statutory and shareholder value reporting purposes.

