

## IFRS FOR SMEs: EVOLUTION AND DISCUSSIONS

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**Abstract:** Research on the harmonization of financial reporting of SMEs worldwide is currently focusing on the global application of IFRS for SMEs as an alternative for the financial reporting of entities whose securities are not listed on a regulated market. Several principles of recognition and valuation of assets have been simplified as a result of revisions made to the entire set of IFRS standards in order to meet the specific demands of small and medium-sized entities (SMEs) in meeting the information needs of readers of financial statements. The proposed goal was reached through the application of the historical research methodology, which involved an examination of the background and development of the IASB's project on the financial reporting of small and medium-sized enterprises, as well as subsequent events following the first and second revisions of the standard. Starting in 2000, when the first discussions about the need for a distinct standard for small and medium-sized entities emerged, to March 2021, when the feedback received following the second Request for Information for revision, the time period studied covered a number of significant events, taking into account that this provides a better understanding of the evolution of the IFRS standard for SMEs. Hence, three time periods were examined: the standard's pre-publication period (2000–2009), its first revision (2009–2015), and its second revision (2019–2021).

**Keywords:** IFRS for SMEs, financial reporting, IFRS, historical research method

**JEL classification:** M40, M41, M48

### 1. Introduction

Because of the increasing globalization of the market, it was essential to develop a unified accounting language that would make it possible for users to comprehend and evaluate various forms of financial information, making it easier for them to get their hands on this data. The fact that foreign investors were required to make comparisons of financial information and, as a result, were in need of access to financial information that was based on harmonized accounting systems was another motivation for the development of this accounting "language" (Beke, 2010).

Adopting a single accounting language was done with the intention of disseminating accurate information that would improve the functioning of global markets and make it more affordable for businesses and other organizations to gain access to financial resources. There were also a lot of people who believed that after the implementation of a single language for financial reporting, the differences that exist between different accounting systems would be eradicated. This, in turn, would make it possible to ensure a high level of information transparency and make financial statements that are easy to understand.

It was anticipated that the use of a single set of standards would make it easier to compare the financial performance of businesses located in various countries; hence, the International Financial Reporting Standards (IFRS) were developed (Jeanjean & Stolowy, 2008). One of the most important shifts in accounting standards in the annals of our industry's long and illustrious past was the adoption of the International Financial Reporting Standards (IFRS) by more than 20 nations around the world for their publicly traded companies (Daske et al., 2008).

By enhancing the overall quality of accounting standards, as stated in the IASB's mission statement, IFRS standards were intended to bring greater levels of transparency, accountability, and

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efficiency to global financial markets (IFRS Foundation, 2018a). Academics, practitioners, and accounting regulators have all found these benefits to be an interesting issue for discussion and investigation. The standards are comprised of a comprehensive set of principles that unavoidably call for information that is consistent, comparable, reliable, and relevant, providing a great deal of value to investors and lenders as well as, more generally, to all those who are responsible for making decisions regarding capital investment. They are also important for the effective operation of a market economy since decisions about the distribution of capital are based on financial information that is reliable and easy to grasp (Panagiotis & Stergios, 2011).

The proposed objective will be accomplished through the use of the historical research method, during which it will be investigated how and why the IASB developed the project on the financial reporting of small and medium-sized entities, continuing with the events that followed the issuance of the standard, respectively the first and the second revision. The time period that will be analyzed will cover a number of significant events, beginning in the year 2000, when the first discussions about the need for a separate standard for small and medium-sized entities emerged, and ending in March 2021, when feedback received following the second Request for Information for revision, due to the fact that this provides a better understanding of the development of the IFRS standard for SMEs. The time period that will be analyzed will cover a time period that will cover a number of significant events. As a result, we will be looking at data from three distinct time periods: the pre-publication period of the standard (2000-2009), the first version of the standard (2009-2015), and the second revision (2019-2021).

## **2. Important phases in the IFRS for SMEs development**

The concern that the full IFRS standards are too complicated and detailed for small entities to produce financial statements, as well as the fact that the full standards exceed both their needs and their capabilities to do so, makes the requirement for a simplified standard for small entities even more necessary. Therefore, the information that is produced as a result of financial reporting in accordance with the standards is regarded as being useful to investors in listed entities. However, this information does not suit the types of lending decisions that must be made by users of financial statements produced by SMEs.

In the following study, we will see what are the key points in the development of the IFRS for SMEs and what are the most recent developments concerning this standard. This study uses a historical research approach to examine the IASB's development of the project on financial reporting of small and medium-sized entities, as well as events after the issuance of the standard and the first and second reviews.

Starting in 2000 when the first discussions about the need for a separate standard for small and medium-sized entities emerged and ending in March 2021 when feedback was received following the two Requests for Information for revision, the time period analyzed covers a number of important events that help shed light on the development of the IFRS standard for SMEs. For this reason, we will divide our analysis into three time spans covering the years 2000-2009 (the period before the standard was published), 2009-2015 (the time period following the first review of the standard), and 2019-2021 (the time period following the second review of the standard).

With the help of a variety of sources of information, including documents, reports, and the comments of significant participants in the phenomenon under study, the historical research technique focuses on capturing and understanding the context, causes, and effects of events, decisions, and connections (Ram & Newberry, 2017). Historical study has significant drawbacks as well, such as the possibility that the reason behind the incident won't be known. However, because historians rely on what is recorded in records and oral histories, which may not give a complete picture of the historical events, it is impossible for them to see or experience exactly what transpired in the past (Parker, 1997).

### **2.1. 2000-2009 - The period before the standard was published**

The forerunner to the current International Accounting Standards Board (IASB), the International Accounting Standards Committee (IASC), recognized the need for a specific set of accounting requirements for small entities as early as the turn of the millennium. This need has emerged in the capital markets as a result of globalization, which has revealed that disparities in accounting practices are a significant barrier to effective capital allocation. As a result, investors and creditors were unable to draw the comparisons they needed across different financial reports. Many meetings were held to highlight the lack of an universal and simplified reporting standard for small and medium-sized enterprises, but this issue was never deemed urgent. For this reason, the Committee spoke with accounting standard setters from 40 countries to discuss the existing state of financial reporting and their thoughts on the necessity of developing distinct standards for small and medium-sized enterprises (SMEs) (Pacter, 2004).

The definition of a small and medium-sized entities (SME), the title of the standard, the proposed goal, whether the standard should be based on the IASB's conceptual framework and, if so, whether it should be based on the full IFRS standards, and which of the categories of users of SME financial statements should be focused were the primary areas of concern for the IASB at that time (IASCF, 2005; Ram & Newberry, 2013). Among the aforementioned, the definition of SMEs represented the greatest challenge. As a result, it was decided to restrict the use of the standard to entities that do not have public liability because there is no longer a need for a globally used definition of SMEs. This decision was made because there is no longer a need for a globally used definition of SMEs. However, with this decision came yet another challenge, and that was determining what really constitutes "public accountability" (Ram & Newberry, 2013).

In order to get feedback on potential simplifications of the recognition and evaluation criteria, IASB released the "Staff Questionnaire on Possible Recognition and Measurement Modifications for Small and Medium-sized Entities" for public comment in April 2005. At the same time, the IASB suggested a number of specific areas that could be taken into consideration. It was forwarded to the working group members as well as to the 120 respondents to the discussion paper and the Standards Advisory Council (SAC). Its goal was to identify the components that the standard shouldn't contain while also identifying several particular components.

IASB published a document titled "Exposure Draft of a Proposed IFRS for Small and Medium-sized Entities" in February of 2007, in which it was stated that IFRS for SMEs is intended for use by small and medium-sized entities (SMEs), these being defined as entities that do not have public accountability, in other words, their shares are not traded. The exposure draft was accompanied by a "Basis for Conclusions" on the Exposure Draft (IASCF, 2007), which presents the main issues addressed by the IASB, the alternatives considered, and the reasons why certain alternatives were accepted or rejected. In addition, an implementation guide, illustrative financial statements, and an information checklist were included.

After the publication of the Exposure Draft, a testing program was designed with the goals of determining the extent of participants' familiarity with the document's component parts, the breadth of its application, whether or not the Exposure Draft addresses all of the transactions and events that arise as a result of the activities that are carried out, the estimation of costs associated with the implementation of the project, and the potential influence that it could have on existing methods of reporting (IASB, 2008).

Between May 2008 and April 2009, IASB once again went through the process of debating the proposals that came from the Exposure Draft. This time, they made sure to consider some of the most pressing concerns that were brought up in the comment letters and tests that were conducted. Many titles were considered and rejected during production. Several perspectives on the standard's name were noticed in responses to the Exposure Draft, although it was possible that different standard-developing bodies and other interested parties might be confused by the title given the breadth of the audience. Apart from the IFRS standards (which total around 3000 pages), the Board announced the IFRS for SMEs in

July 2009, allowing for their adoption by any jurisdiction regardless of whether or not that jurisdiction has embraced the full set of IFRS standards. Training materials in many languages and collaboration with international organizations have been released alongside the standard itself to make the process of training trainers as easy as possible (IASB, 2009).

### **2.2. 2009-2015 - Post-issue period of IFRS for SMEs – The first review of the standard**

Following extensive discussion and debate, the IFRS for SMEs were published in July 2009. The full IFRS standards served as the basis for the standard's development, with adjustments made to account for the demands of users of financial statements prepared for SMEs and to balance costs and benefits. The development process took five years, and participants had multiple chances to provide feedback at key points.

The Board stated that after two years of implementation by small and medium-sized enterprises, it would conduct an initial evaluation of the standard to see whether revisions are necessary. In particular, the Board said it will think about revising the standard to fix the problems encountered during implementation (IASB, 2015).

The Board published the "Request for information" in 2012 with the goal of undertaking a comprehensive assessment to evaluate the concerns raised and make appropriate adjustments to the standard. The Council collaborated extensively with the SME Implementation Committee in the creation of the Request for Information. The document was sent to solicit feedback on whether or not the standard should be updated and, if so, what specific changes should be made. The Request for Information contains specific questions based on issues raised by stakeholders at Board meetings and also questions regarding recent amendments to full IFRS standards, all of which are designed to encourage respondents to answer as subjectively as possible, raising their own issues encountered.

In total, 89 comment letters were received and reviewed by the SME Implementation Committee for this application. Respondents had the most to say about the standard's scope, the IASB's method for handling full IFRS, the availability of accounting policy alternatives (in particular, with regard to the revaluation of property, plant, and equipment), and the frequency of planned review cycles (IASB, 2015). There were some unfavourable viewpoints voiced as well, such as the fact that the adoption of the standard entails substantial expenditures, particularly development costs, in addition to the good ones (Masca, 2012). A lack of professional training plans and inadequate training for accountants are also potential roadblocks to the standard's adoption (Uyar & Güngörmüş, 2013). This lack of readiness shows up most clearly in the fact that few users are familiar with or able to explain the distinction between full IFRS and IFRS for SMEs.

Recommendations for potential IFRS for SMEs amendments were developed in February 2013. In response, the IASB developed the "Exposure Draft of proposed revisions to the IFRS for SMEs" and recommended 57 amendments to the standard. The proposed changes were made to make the standard's principles easier to grasp and to make compliance requirements more explicit (IFRS Foundation, 2013).

After publishing the revisions, the Council issued a new version of the standard in May 2015 that contained only the revisions. A new, revised edition of the standard was published in October 2015, incorporating the significant changes made in May 2015 as well as some minor editing improvements. This new version of the standard becomes effective on January 1, 2017.

### **2.3. 2019-2021 - Post-issue period of IFRS FOR SMEs – The second review of the standard**

The IASB's second review of the IFRS for SMEs began in 2019. Every three years, as required by the standard, the Council conducts this review. The first round of revision started in 2012 and ended with the publishing of revisions in 2015, taking effect on January 1, 2017.

In the first step in its second review, the Council issued a "Request for information" to solicit feedback on whether and how the IFRS standard for SMEs should be updated to reflect the entire IFRS standards and revisions that are not yet reflected therein. The feedback collected will be used by the

Board to decide whether or not to further develop the Exposure Draft on modifications to the IFRS for SMEs.

At the sessions, the members of the Board voiced a variety of opinions on whether or not the IFRS for SMEs should be aligned with the IFRS and how this could be accomplished. This was the case despite the fact that the objective of the Request for Information had already been determined. There were some that agreed with the purpose that was set out in the beginning, and there were others that thought the standard ought to be stable by merely updating particular problems that were brought to the notice of the Board by stakeholders.

During the initial meetings that were held in 2019, the Board came to the provisional conclusion that the scope of the IFRS for SMEs should be included as part of the review. After the initial revision, stakeholders provided comments, which resulted in recommendations being received. These recommendations were connected to considering the scope of the IFRS for SMEs in the 2019 version.

The Request for Information was initially published by the Board in January 2020 with a deadline of July 27, 2020; however, this deadline was later moved to October 27 due to the pandemic context produced by the Covid-19 virus, which globally disrupted actions that had previously been scheduled (IASB, 2020).

In the context of the pandemic, the Board organized virtual meetings with more than 90 jurisdictions in Africa, the Americas, Asia, and Oceania and Europe (IASB, 2020). The goal of these meetings was to reach stakeholders and receive additional feedback related to the proposed review and the issues that were encountered. In addition to that, it offered supplementary resources because the provision of information is an essential component of the evaluation process.

According to the information provided by the IASB in December 2020, as a consequence of the request, 66 comment letters were obtained, and 30 responses were submitted online. At this point in time, it has been taken into consideration that not all stakeholders will be able to answer by sending in a letter of comments. As a result, the option to respond online has been made available on the official website. At the same time, in order to get input from the users of the financial statements for SMEs, an online form was made accessible. A total of 54 replies were received, and interviews were conducted with users from 7 different jurisdictions.

### 3. Conclusions

The IASB developed IFRS for listed entities, but extended its scope to unlisted entities, publishing the IFRS for SMEs as recently as 2009. It was developed using the fundamental ideas from the **IASB Conceptual Accounting Framework**, the mandatory principles and guidelines related to the full IFRS standards, as well as the interpretation and consideration of appropriate changes based on two criteria: the needs of users of SME financial statements and cost-benefit analysis.

As we can see, creating and amending the standard took a considerable amount of time and effort. However, because of this, the IASB's method to creating the IFRS for SMEs also drew criticism, with some believing that using a framework targeted at public interest corporations (the top-down approach) was a mistake (Samujh & Devi, 2015). The SME standard has been adopted by rising economies like South Africa, Malaysia, Brazil, Nigeria, and Ghana, according to the most recent report from the IFRS Foundation on the adoption of the standard globally (IFRS Foundation, 2018b). Unlike in economically developed nations where adoption is seen to be less widespread.

Yet, the requirement applies to all entities—not just small ones—that do not implement other comprehensive international financial reporting standards (Warren et al., 2019). Hence, any organization that satisfies the requirement of not having public obligation is able to utilize IFRS for SMEs, whatever of size (IASB, 2013). The Board decided that it was not feasible to create quantitative standards that would be applicable globally, so it left it up to the various jurisdictions to determine which entities should be required or permitted to use IFRS for SMEs. These jurisdictions are free to establish their own size standards (IASB, 2013).

When the title and definition are compared, it becomes clear that they are in conflict because the

title seems to limit the standard's applicability to SMEs but the description implies that it applies to all non-publicly liable companies. The range of quantitative criteria for this group of entities, which ranged from very small unlisted entities with fewer than ten employees to very large unlisted entities with hundreds or thousands of employees, was too broad, according to some stakeholders, who claimed that it was unrealistic to develop a single standard that could be used by all non-publicly liable entities. Also, small businesses typically have owner control and are more concerned with short-term profit maximization and survival. In addition, SMEs utilize financial statements less frequently and have different information needs than large organizations (Di Pietra et al., 2008; Eierle & Haller, 2009).

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