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INTERNATIONAL FINANCIAL REPORTING STANDARD ON SMEs: OPPORTUNITY TO CHANGE NATIONAL ACCOUNTING LEGISLATURE?

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Abstract. *International Financial Reporting Standard on the Reporting for Small and Medium-sized Entities (SMEs) will be issued in September of 2007. SMEs are defined as entities that do not have public accountability and publish general purpose financial statements for external users such as owners who are not involved in managing the business, existing and potential creditors, and credit rating agencies.*
The paper deals with the new requirements which will be given on the reporting for SMEs and also compares these requirements with the national accounting legislature. The main aim of the presented research is to identify whether it is possible to use IFRS for SMEs as accounting frameworks and also as a national legislature in the European Union countries.

Key Words: *Reporting, SMEs, IFRS*

1. INTRODUCTION

In the year 2002, the Council issued Regulation 1606/2002 whereby it stipulated certain duties on the part of the companies listed on European stock exchanges to compile their consolidated accounting statements in accordance with IFRSs (International Financial Reporting Standards), effective as of 2005 at the latest. Although International Financial Reporting Standards are not deemed an equal alternative to Czech laws regulating the compilation of financial reports, Act 563/1991 Sb., on accounting, nevertheless stipulated that selected accounting entities are obliged to proceed in accordance with IRFSs to compile their financial statement. This exception applies to consolidated accounting entities which have issued securities listed on the official stock exchange market in EU member states. Other accounting entities may choose whether to compile their financial statement in accordance with Czech statutory regulations or in accordance with IFRSs.

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Unlike international standards, Czech accounting regulations lack a glossary of definitions for basic elements of financial statements, which is why we shall use the definitions applied in IFRS/IAS standards, namely in the Framework. Reliable measurement is expected from all entries involved.

Concerning the initial recognition under Czech laws, the Accounting Act (Section 24) identifies the following valuation alternatives:

- ***historical costs***, i.e. the cost of acquisition of the assets concerned, including the costs related to the acquisition itself
  - the historical cost is used to place value on tangible and intangible fixed assets, inventory purchased, securities and interests, derivatives and liabilities procured for consideration or by deposit
- ***replacement/reproduction cost, i.e. the cost at which the assets would be*** obtained at the time of the accounting statement,
  - the replacement costs are used to place value on assets procured gratuitously and assets produced by the enterprise itself, where the enterprise cannot determine the costs required to produce the assets
- ***production costs***, which include all direct costs expended on the manufacturing or other activity and that part of indirect costs, which is related to the manufacturing or other activity involved
  - own costs are used to place value on the processed production, including livestock raised, and tangible and intangible fixed assets generated by the enterprise itself
- ***nominal value***, i.e. the face value
  - nominal value is used to place value on receivables, payables, cash funds and liquid valuables

As of the date of balance, the accounting entities are obliged to record their assets and liabilities as follows:

Entry	**Upon acquisition**	**As of the date of balance**
Intangible fixed assets	historical costs/ replacement costs/ production costs	net book value or the lower of the following (net book value vs. market price)
Depreciated tangible fixed assets	historical costs / replacement costs/ production costs	net book value or the lower of the following (net book value vs. market price)
Non-depreciated tangible fixed assets	historical costs / replacement costs/ production costs	or the lower of the following (historical costs /replacement costs/ production costs vs. market price)
Shares and ownership interests – controlling influence	historical costs	equivalent valuation
Shares and ownership interests – substantial influence	historical costs	equivalent valuation

Entry	**Upon acquisition**	**As of the date of balance**
Realizable securities (long-term)	historical costs	fair value
Inventory purchased	historical costs / replacement costs	or the lower of the following (historical costs /replacement costs vs. market price)
Own products in inventory	production costs	
Receivables	nominal value/ historical costs	or the lower of the following (nominal value/ historical costs vs. market price), or fair value (derivative contracts or receivables hedged by derivatives)
Cash	nominal value	
Short-term securities	historical costs	fair value
Payables	nominal value	as entered in the inventory

In the Czech Republic, values are usually measured through historical prices, while donated or gratuitously procured assets are measured by reproduction acquisition price which is the approximate equivalent of the reproduction cost as defined by IFRS/IAS. Under certain circumstances, also the realizable value and the fair value may also be used as the measurement bases for financial accounting. At the same time, Czech regulations virtually ignore measurement methods based on present value.

2. FINANCIAL STATEMENTS

Under Section 18 of the Accounting Act, the financial statements comprise:

- balance sheet,
- profit and loss statement, and
- notes

At the same time, Section 18 also contains the following unfortunate sentence "*the financial statements* ***may also include*** *a cash-flow statement and the statement of changes in equity.*" This means that under Czech laws, the cash-flow statement is not an obligatory component of the financial statements, not even for the accounting entities which are liable to statutory audit (the accounting entity has to undergo a statutory audit of its financial statement, if it fulfils one or more of the following conditions over two successive accounting periods: the balance sum exceeds the amount of CZK 40 000 000, net sales exceeds CZK 80 000 000, and converted number of employees is higher than 50 persons).

On the other hand, international standards stipulate that the above statements be an integral part of the financial statements. The subsequent text deals mainly with the balance sheet and the profit and loss statement (income statement).

Balance Sheet

Pursuant to the Fourth Directive of the E.U., accounting entities should compile in the Czech Republic the balance sheet horizontally:

Total assets	Total equity and liabilities
A. Receivables from subscriptions	***A. Equity***
	A.I. Registered capital
B. Fixed assets	*A.II. Capital funds*
B.I. Intangible fixed assets	*A.III. Reserve funds, statutory and other funds*
B.II. Tangible fixed assets	*A.IV. Profit/loss of previous years*
B.III. Long-term financial assets	*A.V. Profit/loss of current period (+/-)*
C. Current assets	***B. Liabilities***
C.I. Inventory	*B.I. Provisions*
C.II. Long-term receivables	*B.II. Long-term liabilities*
C.III. Short-term receivables	*B.III. Short-term liabilities*
C.IV. Short-term financial assets	*B.IV. Bank loans*
D.I. Accruals	***C.I. Accruals***

Unlike Czech regulations, international standards do not define accruals and deferrals as separate accounting entries, but rather integrate them among receivables (deferred revenues) and liabilities (accrued expenses).

At the same time, the Czech regulations do not require separate reporting of ***discontinued operations***, while IFRS/IAS stipulate that discontinued operations be disclosed and presented separately in accordance with IFRS 5. In particular, IFRS 5 stipulates that:

- the sum of the post-tax profit or loss of the discontinued operation and the post-tax gain or loss recognized on the measurement to fair value less cost to sell or fair value adjustments on the disposal of the assets (or disposal group) should be presented as a single amount on the face of the income statement
- detailed disclosure of revenue, expenses, pre-tax profit or loss, and related income taxes is required either in the notes or on the face of the income statement in a section distinct from continuing operations

Profit and Loss Statement (Income Statement)

Pursuant to the Fourth Directive of the E.U., accounting entities should compile the profit and loss statement vertically, allowing for the presentation of expenses either according to their nature or function. However, if the profit and loss statement is arranged with respect to the function of entries involved, accounting entity must also include a schedule disclosing the operating costs classified with respect to their nature.

P/L statement (by nature)

+	Revenues from merchandise
-	Costs of goods sold
=	***Sales margin***
+	Production
-	Production consumption
=	***Value added***

-	Personnel expenses
-	Taxes and fees
-	Depreciation of tangibles and intangibles
+	Revenues from disposals of fixed assets and materials
-	Net book value of fixed assets and materials
-	Change in operating provisions and adjustments
+	Other operating revenues
-	Other operating expenses
+	Transfer of operating revenues
-	Transfer of operating expenses
=	***Operating profit/loss***
+	Revenues from sales of securities and ownership interests
-	Securities and ownership interests sold
+	Revenues from long-term financial assets
+	Revenues from short-term financial assets
-	Expenses associated with financial investments
+	Revenues from revaluation of securities and derivatives
-	Cost of revaluation of securities and derivatives
-	Change in financial provisions and adjustments
+	Interest revenues
-	Interest expenses
+	Other financial revenues
-	Other financial expenses
+	Transfer of financial revenues
-	Transfer of financial expenses
=	***Profit/loss from financial operations***
-	Income tax on ordinary income (due, deferred)
+	**Ordinary income**
+	Extraordinary revenues
-	Extraordinary expenses
-	Income tax on extraordinary income (due, deferred)
=	**Extraordinary income**
-	Transfer of ratio in profit/loss to partners
=	**Profit/loss of current accounting period**

P/L statement (by function)

+	Sales of products, goods and services
-	Costs of sales
=	***Gross profit/loss***
-	Selling expenses
-	Administrative overheads
+	Other operating revenues
-	Other operating expenses
=	***Operating profit/loss***
	Financial operations and Extraordinary items – viz P/L statement by nature

Under IAS 1 accounting unit should also report EPS ratio. Unlike US GAAP, international standards do not require that costs be classified as to their function in the profit and loss statement. Instead they only demand that accounting entities submit an analysis of costs classified according to their nature or function, whichever classification provides more reliable or more relevant information. However, the function-based classification allows for an amount of certain discretion with respect to the assignment of costs to individual functions.

There are two basic **differences** between the profit and loss statement compiled in accordance with Czech rules and in compliance with IFRS:

- IFRSs have revoked the obligation to report extraordinary expenses and extraordinary revenues – as of January 1st, 2005, accounting entities disclose extraordinary expenses and revenues under their other expenses and revenues;
- Czech regulations have included the entries ***re-allocation of expenses to inventory and fixed assets*** and ***change in inventory of finished goods and work in progress*** among the revenue entries. However, since IFRS do not recognize the above entries as revenues, they have been included among adjustments to operating expenses.

3. Basic differences in financial statements (Czech standards vs. IFRSs)

- ***balance sheet***

Assets		**Item under IFRS/IAS (reclassification)**
A.	Receivables from subscriptions	IAS 32, IAS 39, IFRS 7 Registered capital
B.	Fixed assets	IAS 16, IAS 17, IAS 28, IAS 38, IAS 40, IAS 41, IFRS 3, IFRS 5
B.I.	Intangible fixed assets	Intangibles Goodwill
B.II.	Tangible fixed assets	Property, plant and equipment Property investments Biological assets Assets available for sale
B.III.	Long-term financial assets	Financial assets Investments in associates
C.	Current assets	IAS 2, IAS 32, IAS 39, IAS 41, IFRS 7
C.I.	Inventory	Inventory Biological assets
C.II.	Long-term receivables	Long-term receivables Deferred tax
C.III.	Short-term receivables	Accounts receivable Other assets
C.IV.	Short-term financial assets	Cash (and cash equivalents) Financial assets Other assets
D.I.	Accruals	Other assets

Equity and liabilities (so called Passives)		
A.	Equity	IAS 16, IAS 32, IAS 38, IAS 39, IAS 40, IFRS 3, IFRS 7
A.I.	Registered capital	Registered capital
A.II.	Capital funds	Capital funds
A.III.	Reserve funds, statutory and other funds	Retained earnings Capital funds Liabilities
A.IV.	Profit/loss from previous years	Retained earnings
A.V.	Profit/loss of current accounting period	Retained earnings
B.	Liabilities	IAS 12, IAS 17, IAS 32, IAS 37, IAS 39, IFRS 7
B.I.	Provisions	Provisions Tax liabilities
B.II.	Long-term liabilities	Accounts payable Financial liabilities Other liabilities Deferred tax
B.III.	Short-term liabilities	Accounts payable Financial liabilities Other liabilities
B.IV.	Bank loans	Financial liabilities
C.I.	Accruals	Other liabilities

- ***balance sheet***
  - unlike Czech accounting standards, a balance sheet includes also assets obtained by financial leasing
  - accruals and deferrals are included among receivables or liabilities
- ***profit or loss statement***
  - IFRS does not include re-allocation of expenses to inventory and fixed assets and change in inventory of finished goods and work in progress among revenues but rather among adjustments to operating expenses (when classified according to their nature)
  - IFRS includes extraordinary revenues and extraordinary costs among other revenues or costs
  - In accordance with IFRS it is necessary to publish also EPS in the profit or loss statement, including both the basic EPS and the diluted EPS
  - According to IFRS, the profit or loss statement must include the sum of the post-tax profit or loss of the discontinued operations shown distinct from other operations

The most significant problem of financial statements and items shown is the complete inconsistency of measurement bases and the application of the historic (acquisition) cost, fair value and the present value. At present, the principle of measurement based on the historical cost fades out as it is being gradually replaced by the IFRS trend of reporting fair values, which are, however, difficult to measure in less transparent markets. At the same time, the reporting based on fair value includes a hidden danger of future volatility of such values and the consequent impact of the changes on financial statements.

Summary of the principal differences in reporting balance sheet entries:

- **fixed assets**
  - ***intangible assets***
    - unlike Czech regulations, the Standards allow the revaluation of an intangible asset even for a higher (fair) value based on the revaluation model, reflected in the capital reserve;
    - unlike in Czech practice, intangible fixed assets do not include organization costs and research, included directly in expenses in the IFRS.
  - ***tangible assets***
    - unlike Czech regulations, the Standards allow the revaluation of a tangible asset even for a higher (fair) value based on the revaluation model, reflected in the capital reserve;
    - unlike in Czech practice, tangible fixed assets include items procured by financial leasing;
    - unlike in Czech practice, it is possible, under certain circumstances, to depreciate property;
    - according to the IFRS, tangible fixed assets also include spare parts, which the Czech Accounting Standards (CAS) recognize as inventories.
- **current assets and liabilities**
  - ***inventories***
    - unlike in CAS, inventories do not include spare parts, which are reported as tangible fixed assets;
    - unlike in CAS, IFRS require a strict distinction between fixed and variable overheads, and do not allow the activation of unproductively expended costs.
  - ***receivables***
    - in accordance with IFRS, long-term receivables should be valued based on their present value, not their nominal value used in Czech regulations;
    - IFRS also recognize active accrued entries as receivables.
  - ***provisions***
    - IFRS do not recognize the "traditional" provision for the repair of tangible assets, which is recognized as a tax-effective expenditure in Czech regulations;
    - IFRS include a provision for income tax in the tax liabilities entry of the balance sheet;
    - under certain conditions, IFRS allow to report provisions at their present value.
  - ***liabilities***
    - IFRS require that long-term liabilities are valued based on their present value, not nominal value as used in Czech regulations;
    - IFRS include accrued liability entries in liabilities;
    - IFRS include the provision for income tax in liabilities

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STANDARDI MEĐUNARODNIOG FINANSIJSKOG IZVEŠTAVANJA ZA MSP: PRILIKA ZA PROMENU NACIONALNOG RAČUNOVODSTVENOG ZAKONODAVSTVA?

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Septembra 2007. godine biće objavljeni Standardi Međunarodnog računovodstvenog izveštavanja za izveštavanje za MSP. MSP se definišu kao organizacije koje nemaju javnu nadležnost i publikuju finansijske izveštaje opšte namene za spoljne korisnike kao što su vlasnici koji nisu uključeni u vođenje poslova, postojeće i potencijalne kreditore, i agencije za ocenu kreditne sposobnosti. U radu se razmatraju novi zahtevi koji se postavljaju pred izveštavanje za MSP i upoređuju se ovi zahtevi sa nacionalnim računovodstvenim zakonodavstvom. Glavni cilj ovog istraživanja je da utvrdi da li je moguće koristiti Standarde međunarodnog finansijskog izveštavanja za MSP kao računovodstveni okvir kao i nacionalno zakonodavstvo u zemljama EU.

Ključne reči: *Izveštavanje, MSP, SMFI.*