

IFRS for SMEs: Challenge for Emerging Countries? Case of Czech Republic and Ukraine

M. Paseková, L. Müllerová, J. Strouhal, L. Chyzhevskya

Abstract—Increase in globalization of capital markets brings the higher requirements on financial information provided for investors who look for a highly comparable information. Paper deals with the advantages and limitations of applying International Financial Reporting Standards (IFRS) in the Czech Republic and Ukraine. As a greatest limit for full adoption of IFRS shall be acknowledged the strong connection of continental accounting to tax system and enormous high administrative burden for IFRS aplifiers.

Keywords—International Financial Reporting Standards (IFRS), Small and Medium-sized Enterprises (SMEs), Czech Republic, Ukraine.

I. INTRODUCTION

IN Europe, full IFRSs are requested for 7,000 listed companies while the majority of companies are non-listed small and medium-sized entities (SMEs). They obviously follow national standards, thus not providing a satisfactory level of international comparability [5]. The IASB (International Accounting Standards Board) issued the IFRS for SMEs in July 2009 and hopes that the application of this standard will increase the comparability of financial statements. The European Commission asked the European Financing Reporting Accounting Group's (EFRAG) advice on whether aspects of IFRS for SMEs could be incompatible with the Directives of EU (namely 4th and 7th Directive). However there shall be stated, according to the results of EFRAG analysis, that standard IFRS for SMEs is not compatible with the EU Directives.

The term "SME" has different meanings in different territories. The definition in the context of the IFRS for SMEs is entities that do not have public accountability and publish general purpose financial statements for external users. Every entity has some form of accountability, if only to its owners and the local tax authorities. Contrary, EU defines SMEs by number of employees, annual turnover and total balance sheet.

Marie Paseková is with the Faculty of Managements and Economics, Tomas Bata University in Zlin, 760 01 Zlin, Czech Republic (corresponding author to provide phone: 420-576 032 404; fax: 420-576 032 402; e-mail: pasekova@fame.utb.cz).

Libuše Mullerová is with the Faculty of Finance and Accounting, University of Economics in Prague, 130 67 Prague, Czech Republic (e-mail: muller@vse.cz).

Jiří Strouhal is with the Faculty of Finance and Accounting, University of Economics in Prague, 130 67 Prague, Czech Republic (e-mail: strouhal@vse.cz).

Ludmila Chyzhevskya is with the Faculty of Accounting and Finance, Zhytomyr State Technical University, Zhytomyr, Chernyakhovskogo 103, 10005 Zhytomyr, Ukraine (e-mail: chizhev@ztu.edu.ua)

In the Czech Republic, the participation of SMEs in employment is around 61.52% and in book value added by 54.57%. SMEs represent 99.83% of the total number of active business entities. In Ukraine SMEs represent 91% of the total number of enterprises. The employed at small and medium businesses make up 56.8% at the number employed.

II. IFRS FOR SMEs

Summarizing previous researches in the field of financial reporting we notice them focusing primarily on two basic aspects – the reliability and the correctness of the valuation [1,3,4]. Previous researches dealing with the probability of using multinational standards [2,6] indicate a positive correlation between the listing of companies on foreign markets and the level of disclosure and use of multinational standards as basis for financial reporting.

The question if SMEs need consistent harmonization has already been discussed for more than ten years. Even in SMEs, there are foreign investors for whom the need of orientation in financial statements is vital. In addition, many of those enterprises are part of consolidating group where same rules, comparable accounting methods and standard procedures are applied.

The IFRS for SMEs react to strong international demands of both developed and newly arising economies to introduce considerably simpler accounting standards for SMEs, compared to IFRS [7]. IASB claims that this standard will:

- enable better comparability for financial statement users,
- improve overall trust in financial statements of SMEs,
- drop important expenses connected with maintaining standards on instate level,
- enable easy transition to full IFRS for growing enterprises which are preparing to join capital markets.

Financial statements prepared in accordance with international standards provide a high level of transparency and comparability. Companies which comply can achieve many benefits, e.g. use of international standards may reduce investor's uncertainty and can thus reduce the costs of capital. It can significantly improve the communication between business users and all their statements.

A key problem of accounting based on IFRS is the tax basis which is received from the accounting profit in the Czech Republic [7]. For this reason, companies reporting under IFRS framework by law have to transform their accounting profit to such a result which they may have according to Czech accounting regulations. The companies which reported also according to another system than Czech modify assessment of assets and financial leases; they also have to modify

provisions, exchange rates, corrections, depreciation, and measurement of inventories, financial assets and accruals. The future reporting according to IFRS is most interesting for companies from the trading sphere; on the other hand production companies have a rather conservative approach to the problems of accounting standards. It is interesting that all companies show a relatively high interest in training in this sphere. Some of the main differences of Czech regulations from IFRS are: the impossibility of measurement based on present values, the focus on prudential values, reporting on financial leases (focus on form over substance in the Czech regulations), the existence of extraordinary items, lack of separate presentation of discontinued operations.

The situation in Ukraine is almost similar to the Czech case. Upon initial recognition there are used historical costs according to Ukrainian national accounting legislature and companies shall measure all assets also at historical costs upon balance sheet date. The only exemption is measurement of finished goods and work in process that are not revaluated upon balance sheet date. However, it shall be stated that majority of balance sheet items are reported in one item and investors do not have the information about the value of each of the assets or liabilities.

III. RESEARCH OUTLET

115 enterprises took part in questionnaire research from the Czech Republic and 50 enterprises from Ukraine. We involved businesses with less than 250 employees in the SMEs category. Structure of respondents by type of activity is summarized in Table 2.

TABLE II STRUCTURE OF RESPONDENTS BY TYPE OF ACTIVITY

		Country	
		Czech Republic	Ukraine
Type of activity	Production	26.1 %	38.0 %
	Trade	25.2 %	30.0 %
	Services	48.7 %	32.0 %

The general question of the questionnaire is aimed at the problems of reporting, i.e. whether the company also prepares its financial statements based on any than national accounting system. Just three Czech companies and any Ukrainian company report also under other than local accounting framework. Out of these, three Czech companies report according to IFRS, and one Czech company according to the French GAAP. The Czech companies reporting under IFRS framework find the biggest problem in reporting of long term assets, provisions, exchange rates differences and financial leases. It is given by the impossibility of measurement at present values in the Czech Republic. According to the problem of reporting of financial leases, Czech accounting system is based on the “substance-over-form” approach which is totally different from the logic of “economic user” based in IFRS (IAS 17).

Figure 1 represents the linkage to foreign entities. In the

Czech Republic nearly 47 % of companies have this type of connection, 17.4 % of companies have an important foreign supplier, 17.4 % of companies have an important foreign customer, and 10.4 % of companies are linked to a foreign parent company. In Ukraine 22 % of companies have this type of connection, 14 % of companies have an important foreign customer, 4 % of companies have an important foreign supplier, and 4 % of companies are linked to a foreign parent company.

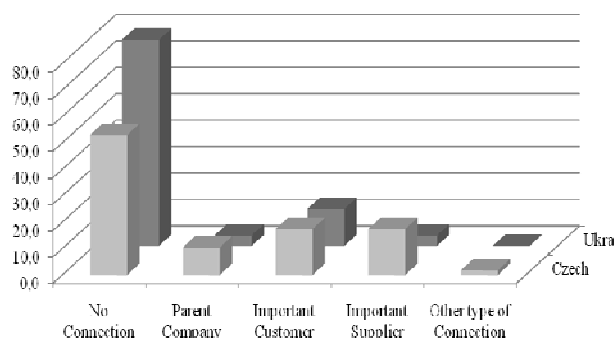


Fig. 1. Connection of Companies to Foreign Entities

Further processing of the results of the questionnaire is aimed at companies currently reporting only under national accounting framework (112 Czech and 50 Ukrainian companies). Another set of questions dealt with the interest of companies in IFRS reporting and what benefits they expect from the use of global accounting referential. Relative frequency of positive answers is provided within the chart in Figure 2.

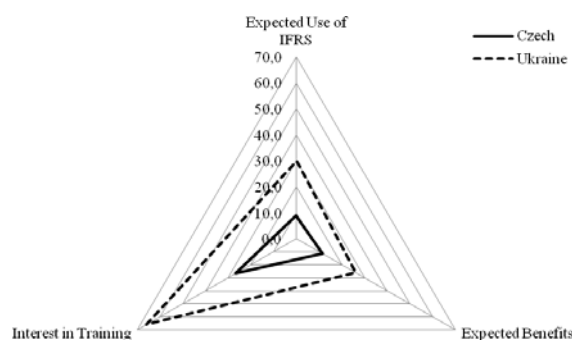


Fig. 2. Per Cent of Positive Answers Connected with the Future Use of IFRS

In both countries, the proportions of positive responses to the three questions provided by the companies with different types of activities are relatively the same. Very important

output is high interest of companies in accounting trainings on IFRSs. The frequency of positive answers is approximately two times higher for Ukrainian companies than for the Czech ones.

To find out how the companies evaluate the various areas of accounting and difficulty of transition to reporting by IFRS, they were asked to select the areas of their accounting that appear to them as important and also select those considered to be difficult. In both cases, they have possibility to select areas from the following reporting items: inventories, receivables, accruals, long-term assets, financial assets, equity, liabilities, expenses and cost.

Relative frequencies of accounting items chosen are provided in Fig. 3 and 4.

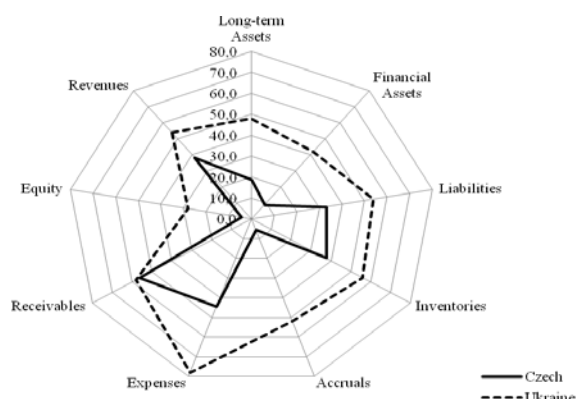


Fig. 3 Frequency of Accounting Items Considered as Important in Per Cent

Rates of representation of items considered important are very similar in both countries. Generally, a lower proportion of Ukrainian companies rate individual spheres of accounting as important.

The Ukrainian companies claim in accordance with Czech companies their accounting practice is focused mainly to areas of liabilities, inventories, expenses, receivables and revenues.

The receivables, inventories and expenses are the most often selected problematic items. The problematic items also include long-term and financial assets and accruals but with less incidence ratio.

Unlike Czech companies, the Ukrainian companies claim that items important for their accounting practice are liabilities, inventories, expenses, receivables and revenues. Receivables, inventories and expenses also appear among items considered as potentially problematic. The problematic items also include long-term and financial assets and accruals. It is interesting that revenues which are often mentioned as important are not considered problematic by companies.

The Czech companies consider the inventory, financial assets and receivables items important, among the problematic items for Ukrainian companies emerge expenses, receivables, revenues, payables and inventories.

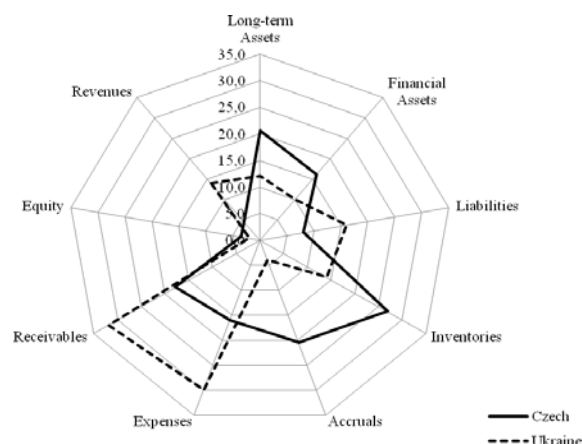


Fig. 4 Frequency of Accounting Items Considered as Problematic in Per Cent

IV. DISCUSSION AS BASIS FOR CONCLUSION

Only a small percentage of SMEs is really interested in providing “true-and-fair view”. Still, majority of companies use accounting just to provide data which are necessary for calculation of the tax base; accounting information for the managerial purposes are rarely used by SMEs.

The SMEs in both countries are only weakly interested in reporting under IFRS. They state that application of IFRS is for them an inadequate administrative burden compared to the revenues obtained.

The imperfection of available database on SMEs businesses does not allow accomplishing the complete analysis of development and significance of the small entrepreneurship in the forming of macroeconomic indices in Ukraine. It can be explained by the fact that there are no unified criteria for small business entity for the purpose of statistics and financial accounting.

Taking into consideration the changes in IFRS and lack of the unanimous opinion of EU member countries concerning the perspectives of applying IFRS for SMEs we believe it is necessary to form the national conception of simplifying the accounting system and financial reporting.

ACKNOWLEDGMENT

This paper is one of the research outputs of projects GA402/09/0225 ‘IAS/IFRS Usage in Small and Medium-sized Enterprises and its Influence on Performance Measurement’ and GA402/08/P024 ‘Analysis of Valuation and Reporting of Financial Securities by Listed and Non-Listed Companies in Czech Republic’ registered at Czech Science Foundation (GAČR).

REFERENCES

- [1] S. Aisbitt, “Measurement of Harmony of Financial Reporting within and between Countries: The Case of the Nordic Countries,” *European Accounting Review*, vol. 10, no. 1, pp. 22–51, 2001.
- [2] H. Ashbaugh, “Non-U.S. Firms’ Accounting Standards Choices,” *Journal of Accounting and Public Policy*, vol. 20, no. 2, pp. 129–153, 2001.

- [3] E. Emenyonu, S. Gray, "International Accounting Harmonisation and the Major Developed Stock Market Countries: An Empirical Study," *International Journal of Accounting*, vol. 31, no. 3, pp. 269–280, 1996.
- [4] D. Herrmann, W. Thomas, "Harmonisation of Accounting Measurement Practices in the European Community," *Accounting and Business Research*, vol. 25, no. 100, pp. 253–265, 1995.
- [5] Jermakowicz, Gornik-Tomasevski, "Implementing IFRS from the perspective of EU publicly traded companies", *Journal of Accounting, Auditing and Taxation*, vol. 15, pp. 170-196, 2006.
- [6] C. Leuz, "IAS versus US GAAP: Information Asymmetry-Based Evidence from Germany's New Market," *Journal of Accounting Research*, vol. 41, no. 3, pp. 445–472, 2003.
- [7] J. Strouhal, L. Mullerova, Z. Cardova, M. Pasekova, "National and International Financial Reporting Rules: Testing the Compatibility of Czech Reporting from SMEs Perspective," *WSEAS Transactions on Business and Economics*, vol. 9, no. 4, pp. 432–441, 2009.

Marie Paseková is Associate Professor at the Department of Finance and Accounting of Tomas Bata University Zlin. She is an author of several monographs and research papers in the area of financial reporting of small-and-medium sized enterprises.

Libuše Müllerová is Professor at the Department of Financial Accounting and Auditing of University of Economics Prague. She is a leading expert on the area of taxation and accounting in Czech, being also a member of National Accounting Board. She is the founder member of Chamber of Auditors Czech Republic (1992). Currently she acts as Vice President of this Chamber.

Jiří Strouhal is Senior Lecturer at the Department of Financial Accounting and Auditing of University of Economics Prague. He is a member of WASET scientific and technical committee and editorial review board on humanities and social sciences. He is the accounting expert (Union of Accountants) and member of Association of International Accountants (FAIA). He is an author of 20 monographs in the area of financial reporting and corporate finance and more than 50 papers in referred journals (ISI and SCOPUS included). From 2007 – 2009 he was Executive Board member of Chamber of Certified Accountants (in 2009 even Vice-Chairman); currently being the Vice President of Chamber of Certified Accountants Czech Republic.

Ludmyla Chyzhevska is Doctor of Economic Sciences (Dr. hab.), professor, Head of the department of Business and Financial Control of Zhytomyr State Technological University, Head of Zhytomyr State Technological University of Ukrainian Federation of Professional Accountants and Auditors. Head of the Department Business and Financial Control. The author of monographs and articles dedicated to the problems of accounting profession development as well as accounting theory and methodology.