

INTERNATIONAL ACCOUNTING STANDARDS FOR SMES (EMPIRICAL EVIDENCE FROM SMES IN A COUNTRY IN TRANSITION AND IN A DEVELOPED COUNTRY FACING NEW CHALLENGES)

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1. Introduction

This study emerged from our curiosity to analyse the change in financial reporting of small and medium-sized enterprises (SMEs) located in two European countries that are geographically similar but economically different. The epithets we attribute to these countries – “transitional economy” for Croatia and “developed economy facing new challenges” for Italy – reflect existing institutional and economic differences between the two countries.

Problems will be analysed from a scholarly accounting perspective, which aims to achieve social and economic improvement by SMEs.

An *a priori* aspect to be considered is that it is not easy to identify SMEs, since the concept of dimension is relative, and any cut-off is hard to justify. According to the Bolton report (1971), a small business is legally independent, with a small market share, owned and managed by the same individual or group of individuals. Thus, from a qualitative point of view, we are assuming that the fundamental feature that distinguishes a small business from others is the limited composition of its ownership and management.

To define small and medium-sized companies, the Fourth Directive, which outlines the basic financial reporting rules for European Union companies, has adopted quantitative criteria. Thus, from a quantitative point of view, we are assuming that SMEs can be classified as small or medium-sized if, for two consecutive years, they do not go beyond two of the thresholds defined by art. 11 of the Fourth Directive (*see table 1*).

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Tab. 1 - Criteria for small and medium sized companies (IV Directive)

	SMALL	MEDIUM
Balance Sheet Total	€ 10 million	€ 47 million
Net Turnover	€ 10 million	€ 50 million
Average Number of Employees during the Financial Year	50	250

Source: Rule 2003/361/EU

Our contribution is a survey, from both a theoretical and empirical point of view, on the applicability of International Accounting Standards (IAS/IFRS) to SMEs, which is one of the most important topics of the current international debate among accounting scholars and professionals.

2. The literature on SMEs' financial reporting

In order to define what structure and contents the annual report of small firms should have, scholars and professionals agree that one should balance the benefits and costs of different functions in accordance with their perceived importance.

Benefits of information

Benefits are related to the use the readers make of the financial report.

Relatively few empirical studies have focused on financial reporting by small companies, and only a small portion of the literature documents empirical work concerning the use the readers make of it (Abdel-Khalik (1983); Page, (1984); Carsberg *et al.* (1985); Paoloni and Demartini (1997); Dugdale, Hussey and Jarvis (1998); Moneva *et al.* (2001); Demartini *et al.* (2005)).

The results of the above-mentioned research show that for company owner-directors, the most important users of the small company financial statements are the SME's top management, the tax authorities and the banks. Indeed, the value of financial reporting as a source of information for owners who do not operate inside the firms, as well as for clients and suppliers, is regarded as of little importance.

In the last few years, however, providing information to the bank is becoming more and more important in many European countries, such as the UK, Spain and Italy (*see table 2*).

Tab. 2 - Researches on SMEs' annual accounts uses. An international comparison

Research (author, year)	Page 1984	Carsberg et al. 1985	Dugdale et al. 1998	Moneva et al. 2001	Paoloni Demartini 1997	Demartini et. al. 2005
Country	UK	UK	UK	SP	IT	IT
Management information	1	1	2	5	1	1
Supporting tax computations	2	2	3	4	2	3
<i>Providing information to the bank (and other financial providers)</i>	3	3	1↑↑	1	3	2↑
Reporting state of affairs to shareholders	4	4	-	3	4	5
Information for trade creditors	5	-	4	2	5	4
Other (Information for employees)	5	-	5	-	6	6

Costs of information

All costs are borne by the firm. Financial reporting is burdensome because it involves additional administrative costs. Furthermore, the business may suffer from the disclosure of information to its competitors and owners (Carsberg *et al.* (1985)).

Thus, following the aforementioned considerations, it is reasonable to state that differential reporting should improve financial accounts for small businesses in two different directions:

- making financial reporting more useful both for management purposes and for banks' credit decisions;
- reducing the costs of disclosure of financial information.

However, arguments against elaborating differential reporting for small businesses exist.

Universal accounting standards in the drawing up of financial reporting promote comparability; comparability is important for external users of companies' annual accounts, especially investors and banks.

The latter motivation is the reason why accounting regulators have preferred to relieve SMEs from some disclosure requirements rather than to issue a differential financial reporting tailored on the need of small businesses.

In the last few years, regulatory institutions have begun to reduce overburdened administrative costs for SMEs (see The Bolton Report, Committee of Inquiry on Small Firms (1971), chap. 17; AICPA (1976); ECC (1994)).

Thus, for example, the Fourth European Directive (78/660/CEE revised by 90/604/CEE) has established different financial reporting requirements according to the size of firms and, in 1997, the UK Accounting Standard Board (ASB) issued a financial reporting standard for small entities (FRSSE) that exempts small entities from certain provision of accounting standards.

The big GAAP/little GAAP debate in the United States

Since the Eighties, experts in the United States have analyzed the possibility of developing a set of generally accepted accounting principles (GAAP) for private companies, independent of their dimension.

The U.S. standards-setting body, the Financial Accounting Standard Board (FASB), commissioned a study by Professor Rashad Abdel-Khalik (1983), which focused on information needs and costs and benefits perceived by different categories of financial reporting users.

Its main conclusion is that “a difference in perception brings questions about financial reporting by private companies into the political sphere, which is common when conflict of interest, not theory or rationality, dominates the issues” (Abdel-Khalik (1983)).

As a consequence, the FASB, considering it politically important to safeguard bank's information needs, decided to not develop special GAAP for private companies.

In our opinion, the U.S. experience is interesting because it highlights the main difference existing between the North American and the European approach to define companies' financial reporting requirements.

The major objective of U.S. GAAP is to promote efficiency on Capital Markets, while the European Legislator, in defining accounting requirements for companies, aims to promote both economic and social progress of the Member States economy.

3. The IASB project and the need for accounting harmonisation

The International Accounting Standard Board (IASB) was born in April 2001 as an emanation of the International Accounting Standard Committee Foundation (IASC). Its members were named by the IASC Foundation, among international accounting experts from Academies, Accounting Professions and Consultants. The objective of IASB was to prepare and approve IAS/IFRS such as a corpus of rules to harmonise listed entities' financial statements all over the world, rendering them more suitable than the IAS previously could to globalised capital markets.

The IASB project was accepted by IOSCO (International Organization of Securities Commission) and the European Union (1606/2002/EU Rule

and 1725/2003/EU Rule), and from 2003 IASB started an interesting debate about advantages and disadvantages to make a set of standard for SMEs (called IFRS for SMEs).

Thus, the IAS/IFRS project briefly include a framework and a set of standards for all listed entities (Delvaile *et al.* (2005); Loli and Casò (2002)). In Europe, this set of standards became compulsory for consolidated European listed entities' financial accounting statements starting on 1st January 2005. It also became optional for European governments to adopt IAS/IFRS in consolidated and financial statements of non-listed entities.

Otherwise, in Europe there is a great debate about FULL IFRS and IFRS for SMEs; interesting contributions have been made by scholars from the European Accounting Association (Evans *et al.* (2005)).

IAS/IFRS are best conceptualized as international standards, planned for all enterprise typologies. In fact, in an IASB document we can read as follows: "The objective of financial statements as set out in the IASB framework is appropriate for SMEs as well as for entities required to follow full IFRS therefore, full IFRS should be regarded as suitable for all entities," but with some exceptions: "The board will develop a set of financial reporting standards that is suitable only for those entities that do not have public accountability (IASB standard for SMEs) " (Preliminary Views on Accounting Standards for SMEs-Discussion paper (2004)).

Describing the applicability of SMEs' accounting principles, the above-mentioned document does not define SMEs using quantitative parameters that should be stated by each national legislator.

So the "full" utilization of IFRS is strictly connected to the entities that have public accountability, and, that above all, to those entities who are compelled to disclose to investors, whereas IFRS for SMEs are considered suitable for entities without a public accountability.

However, actually a distinction between an "entity that has public accountability" and "entity that does not have public accountability" is not as clear, because stakeholders are even more demanding, such as: "There is a high degree of outside interest in the entity from non-management investors or other stakeholders, and those stakeholders depend primarily an external financial reporting as their means of obtaining financial information about the entity" (Preliminary Views... (2004)).

Furthermore, we wonder if the IASB project for SMEs is a simplification or an informative loss for SMEs and their stakeholders. The outcome of the 2004 and 2005 IASB studies attempted to give an answer to this question. It established that there is a large interest at European level about on accounting simplification, provided that it would not cause an excessive informative loss (Campedelli, (2005)).

Therefore, IASB orientation is toward a reasonable simplification trying to avoid loss of relevant information.

The above-mentioned aspects are the main topics of IASB debate. Then, from a technical point of view, we think that the following IASB considerations represent the starting point for a deeper analysis: "Standards in full IFRS that address transactions, events or conditions commonly encountered by SMEs should be included in the IFRS for SMEs, either directly or by cross-reference back to the full IFRS. Standards relating to transactions, events, or conditions not generally encountered by SMEs should not be included in the IFRS for SMEs... If the IFRS for SMEs does not specifically address a transaction, event or condition, an SME should be required to look to the requirements and guidance elsewhere in the IFRS for SMEs dealing with similar and related issues - that is, select an appropriate accounting policy "by analogy" (IASB UPDATE- Board Decisions on IFRSs 2006)).

4. The UNCTAD project

In addition to the IASB's project, there was another SMEs accounting-related endeavour supposedly developed in close collaboration with IASB – the UNCTAD's project. This was interesting not only because it considered different accounting needs for different enterprises levels, but also because it kept in mind harmonization goals by incorporating international accounting standards in the whole story. UNCTAD's Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has issued Accounting and Financial Reporting Guidelines – SMEGA Level 2 and SMEGA Level 3 in September 2003, as the final output of the three-year activities on this project. These guidelines are based on ISAR's three-tiered approach (Accounting by SMEs, UNCTAD-ISAR (2001/02)):

1) The most sophisticated level would comprise a tier of entities that need to comply with all International Accounting Standards - IAS (Level I), which included listed enterprises and enterprises of significant public interest (as well as banks and financial institutions).

2) The second level (Level II) would be larger SMEs that did not issue public securities and did not prepare financial reports for the general public. Full IAS might be beyond their needs since they are less likely to have transactions foreseen in the more complex standards and the costs could outweigh the benefits. It is preferable that these enterprises use a condensed, specified set of standards (15 guidelines drawn from 16 IAS were recommended based on their frequency of use and degree of complexity), which covers most of their transactions in accordance with 80/20 rule, whereby 20 per cent of the standards cover 80 per cent of SMEs transactions.

3) The Level III would be applicable for smaller entities that have limited availability of, and access to, accounting expertise; they would therefore be required to provide simplified accounts that comply broadly with the essential principles of accruals accounting (with proposed simple chart of accounts and standard financial statement formats and some suggestions to allow the new entrants to do cash accounting for a brief period).

The system covers all commercial entities in an economy and enables small businesses to advance to full IAS compliance as they grow. The boundaries between levels are left to be defined by a given country depending on its economic, legal, social circumstances and country's enterprises structure.

5. The relevance of environmental factors for SMEs' financial reporting

Although SMEs share common accounting problems the world over, considering both the necessity of set standards feasible to their needs on a cost-benefit basis, and also taking into account globalisation and accounting harmonisation pressure, there are also specificities depending on the environmental factors of influence in a given country. The environmental influential factors are grouped as follows (Choi, F., Mueller, G.G., Da Costa, R.C., Bourgeois, J.C., Lawson, W.M., Gray, S.J., Mathews, M.R., Olusegun W.R.S., Perera, M.H.B., Qureshi, M.A. in Lawrence (1996)):

- *cultural* (assumptions and attitudes towards reporting: e.g. using relevant information to try to influence the future, or believing in "fate"; personal beliefs, aspirations and motivations: e.g. short-term orientation on periodic profit or long-term emphasis on the balance sheet, society's or personal gain putting in the first place; the amount of government regulation; the varieties of social structure (widespread ownership or family-owned businesses); the status of the accounting profession, etc.),

- *political* (the form of country's government: centrally planned economies versus free market economies; the level of government control and legal system influence: laws versus standards; political regimes and historical political influences),

- *legal* (tax regulation influences; the extent of the legal system, detailed accounting legislation passed by governments or accounting standards developed by the accounting profession),

- *economic* (type of organization; the sources and methods of financing: more conservative accounting practices with banks as the main source versus more liberal practices with shareholders financing; the importance of investors, economic developments; role of accountants; users' the level of sophistication).

These factors, and their diverse combinations, cause SMEs' financial re-

porting to differ significantly across countries.

This is why the harmonisation of environmental factors, particularly institutional ones, is widely considered to be the prerequisite of accounting harmonisation. In practice, this means that harmonisation of the SMEs' financial reporting also could not be achieved without harmonisation in the field of small business corporate governance law, corporation tax law, and financial markets for small business (Demartini et al.(2005). Considering the pressure to reach harmonization goals by implementing the IAS/IFRS across the EU and beyond, environmental factors become even more emphasized. This is made especially clear when comparing the possibilities of SMEs applying IAS/IFRS in developed countries, versus those in developing or reforming countries. "Since IFRS have been created largely for transnational enterprises operating from developed-country bases, it is difficult to apply them to SMEs in developed countries and even more difficult to do so in significantly different economic environments" (Accounting by SMEs, UNCTAD-ISAR (2004, 27)).

Thus the main hypothesis of our study is that:

Hp1. The accounting and financial reporting problems of SMEs in any country cannot be discussed without analyzing the country's specific environmental factors.

In order to verify our hypothesis, empirical evidence from two European countries, Croatia and Italy, are hereby presented.

6. The Croatian case

The impact of Croatian environmental factors on SMEs' financial reporting

The transition processes of Croatia's ex-planned economy, based on social ownership, were taking place from the early 1990s onwards. These processes were characterized by high inflation until 1994, the disappearance of big state- or socially-owned enterprises, high unemployment, and the emergence of a great number of small enterprises. Accounting reform began immediately, in an attempt to align with the new requirements of the changing business environment. Previously, accounting was nothing more than bookkeeping – a passive, static, uniform system that existed solely to meet the rules and information requirements typical for a planned economy with high government regulation and legal system influence. Standardized charts of accounts and financial statement structures were in use, and detailed accounting legislation passed by the government, instead of accounting standards developed by profession, made accounting to be simply a routine practice of following the rules. These rules changed often, and accountants typically lost a great deal of time trying to get acquainted with the new ones; in effect, all their time was spent serving the

social/state interest, and very little time was left for cost or management accounting. The banks were the primary source of financing, so there were no potential investors or shareholders that needed sophisticated accounting information that would serve private interests. Thus, accounting reform had to transform the uniform and passive accounting system into a modern one comparable to its role and function in developed countries. Consequently, the new Croatian Accounting Act was introduced in 1993. It adopted more investor-oriented approach that focused on capital markets needs. Growing the capital market was crucial for the development of the Croatian economy, and so it was important to protect investors by providing transparent, high quality, trustful financial statements. That's why this Act introduced IAS as mandatory for all entrepreneurs regardless of their size, which created additional burdens to SMEs.

Croatian SMEs in this research were defined according enterprises' size classification criteria set up by Accounting Act from 1993 that were presented in the following table together with the criteria defined by the new Accounting Act in force from 2006.

Tab. 3 - Enterprises' size criteria in Croatia

Balance sheet total (in euros)		Annual turnover (in euros)		Average number of employees	
Small	Medium	Small	Medium	Small	Medium
1.000.000	4.000.000	2.000.000	8.000.000	50	250
3.650.000*	14.600.000*	7.300.000*	29.200.000*	50*	250*

*criteria set up by the new Accounting Act in force from 2006

Source: The Croatian Accounting Act, Official Gazette, 90/92, 146/05.

The enterprise was considered to be of small size if it didn't exceed 2 out of 3 criteria set up for small entities. Middle-sized enterprises were those ones that exceeded 2 out of 3 criteria (for small ones), but never exceeded two out of 3 criteria set up for medium enterprises. Otherwise, the enterprise was classified as large.

SMEs account for 98% of all enterprises in Croatia, employing 55% of the total number of persons in paid employment and contributing 43% of the country's total revenue (Financial Results of Enterprises, Croatian Financial Agency 1999-06/05 (2005)). SMEs' particular information needs must therefore be taken into account. Requiring them to prepare comprehensive information in accordance with full standards when the benefits of their disposability are overcome by their preparation costs, is certainly not a good practice leading to the accounting system to be considered just as a costly burden. Such a situation called for urgent solutions.

Croatian SMEs' internationalisation process and the need for accounting harmonisation

Requiring all the entrepreneurs, independent of their size, to implement IAS was an attempt to initiate accounting reform, while also furthering harmonization goals at the same time. Achieving harmonisation goals is particularly important for the Croatian economy starving for fresh capital, since making investment, financial, and other business decisions between numerous types of Croatian businesses and foreign companies requires comparable financial reports and harmonized accounting systems. Effective integration into accounting harmonization flows is related to efficient participation in the globalization processes, which is imperative for a small economy like Croatia's. The EU harmonisation processes have been intensifying towards the adoption of IFRS/IAS, and sticking to the European accounting developments is also necessary to the Croatian mission of eventually joining the EU.¹ SMEs are certainly not exempted from those internationalisation processes - 70% of the examined Croatian SMEs in 2005 were somehow related to the businesses abroad. Participation in harmonisation processes does not mean sticking to full IAS/IFRS, but to the particular set of internationally accepted accounting standards for SMEs or to the set of national standards closely harmonised with international ones.

The adoption of IFRS by Croatian SMEs

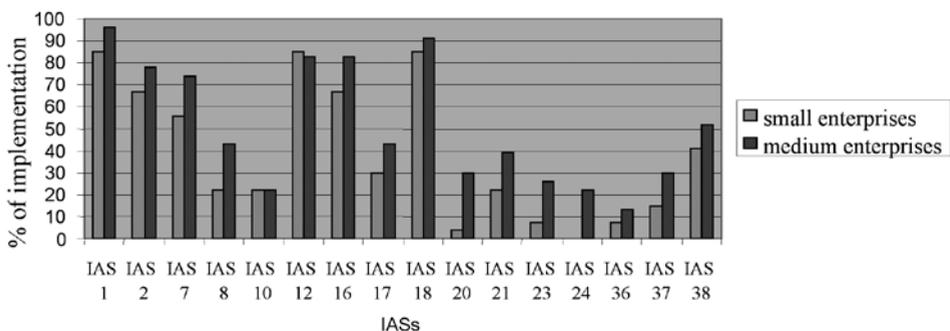
The results of this study of IAS implementation problems in Croatia are presented below. The research performed in 2004-2005 was based on questionnaires sent to a random sample of 430 SMEs (SME definition is given in table 3) with a 12% rate of return. The SMEs in the sample were selected randomly out of 64.057 SMEs at the whole territory of Croatia, so there were no selection biases based on exclusions of any county, industry, type of ownership, profit range, date of establishment, etc. Structural and comparative analyses were employed in data processing. There were 54% of small enterprises and 46% of middle-sized enterprises in the sample, 80% of all the enterprises were limited liability companies, 16%

¹ Croatia is obliged to adopt the EU juridical legacy in the field of accounting - section 69 of *Stabilisation and Association Agreement and National programme for Integration of the Republic of Croatia into the EU for 2005*, chp. 3.5. *Company Law*, 3.5.4. *Accounting*. That's why new Accounting Act was introduced in 2006.

joint stock companies with 70% of the sample related to business abroad and with owner performing management function in 74% of cases. Almost 40% of the small enterprises sampled in this study employed book-keeping agencies, while most of the medium-sized enterprises organized their accounting functions from inside the enterprise. The most important users of accounting information and financial reports were ranked as follows: the first were owners and managers, followed by the government and lenders, then potential investors, suppliers, customers and employees. The financial reports were used more regularly in middle-sized enterprises than in small ones, wherein 33% of the cases they were used only occasionally. The latter stood for all the enterprises in the sample characterized by owners performing management function, while for 70% of occasional users, the accounting information was provided by outside agency. The explanation of non-regular use of financial statements under current accounting regulation was found to be in discordance with that of the users' needs (47% of cases); they considered accounting as nothing more than a mandatory burden (27% of cases). Among other reasons in the sample, they also viewed it as complex, and considered themselves as lacking the ability to understand accounting information (in 20% of cases). Such a condition resulted in the fact that for 28% of small enterprises the costs of accounting information preparing were just partially offset by the benefits of their use, while this percentage was twice lower for the middle sized enterprises group.

We explored the application of those 16 IAS condensed into a set of 15 guidelines according to previously presented ISAR's proposal for Level 2 entities (see fig. 1).

Fig. 1 - The implementation of selected standards in Croatian SMEs in 2004/05



Source: Mošnjica-Škare (2005).

It was obvious that even such abridged set of standards in many cases did not meet the Croatian SMEs' needs, and further simplification and improvements were necessary.

The results of the study were expected considering Croatian specific en-

vironmental factors. Among the strongest ones was high amount of government regulation that was a barrier of accounting profession development since accountants were oriented just on following the rules instead on developing of accounting standards that would serve the users' needs in the best way. Croatia was an ex-planned economy with high level of government control and legal system influence. The result of detailed accounting legislation was poor accounting profession status, insignificant accountants' role and underdeveloped accounting standards structuring and implementation. Furthermore, IAS were supposed to be oriented in the first place to investors and to the widespread ownership, i.e. to serve the external users interests, but majority of Croatian SMEs were family-owned businesses or partnerships without significant interest of outside investors and shareholders (with the banks as their main financial source). In such conditions, tax regulation had the most important influence on financial statements preparation that were more tax driven than founded on accounting standards.

Transitional processes in Croatian economy have been going on, the markets are developing and the needs for high quality accounting information are becoming evident since more sophisticated information users are emerging.

The implementation of IFRS is still required by new Croatian Accounting Act in force from January 1, 2006, but it differs from the previous Accounting Act (1993) since such a requirement is no longer obligatory for SMEs. Now, they can choose between the full IFRS implementation (obligatory for large and listed companies) and the financial reporting standards in accordance with IFRS, issued by the Croatian Financial Reporting Standards Board.

7. The Italian case

7.1. *The impact of Italian environmental factors on SMEs' financial reporting*

Nobes' classification (1992) suggests that the Italian accounting system belongs to the same family of several other continental European countries (such as Luxembourg, Germany, Greece, Belgium, Portugal, Spain, France), who have an accounting system defined *macro-uniform, government-driven, tax-dominated*. In summary, in these continental European countries, the importance of Governments as tax collectors or controllers of the economy have led to the enhanced importance of taxation requirements and of uniformity of measurement and presentation in the drawing up of company annual reports.

Focusing on the Italian case, companies whose partners have limited li-

ability are required to publish annual accounts following format, contents and valuation criteria stated by specific sections of Company Law included in the civil code. Furthermore, given the different alternatives offered by the Fourth Directive, Italy introduced abridged annual accounts for small sized companies.

Since the first of January, 2005, listed firms belonging to an EC country are obliged to draw their consolidated financial reporting following IAS/IFRS (EC Regulation no 1606/2002).

Furthermore, the Italian Legislation decided to introduce, even for non-listed companies, the option of the drawing up of IAS/IFRS annual accounts, both consolidated and not consolidated (see Law no 31/2003 and D.Lgs. no 38/2005).

But at the moment, small companies allowed to draw abridged annual accounts are exempted from these requirements, and even if they are highly involved in the internationalisation process, they can not implement IAS/IFRS in their mandatory annual accounts.

However, in practice, Italian tax law influences accounting measurements. Before the last reforms of Italian commercial and tax laws in 2003,² tax Authorities acknowledged costs only if they were included in the financial reports. Examples are easy to find: depreciation, provisions and maintenance expenditures were often calculated and included in the profit and loss account in order to reduce taxable income.

Nowadays depreciation and provision costs, recognised only as serving to reduce the amount of income tax, should be included in a separate report drawn only for tax Authorities. But it has to be considered that the owner-managers' aim is to minimise taxation payable of the aggregate family-firm. To give an example, emoluments of his son or his wife employed in the company may exceed the amount that would have to be paid to another employee to carry out the same work. This practice may not be regarded as "fair," although it is certainly "correct" or "legal".

As a result of this, still nowadays, the annual report of Italian small companies may fail to give a "true and fair view" of the company's net worth and financial position.

Italian SMEs' internationalisation process and the need for accounting harmonisation

Considering the results of a survey on highly internationalised Italian SMEs (Angeloni *et al.* (2003)), the above-mentioned decision to exempt smaller entities from the drawing up of IAS/IFRS annual accounts, seems to be consistent with the information needs of their foreign stakeholders. In

² See D.Lgs. no 394/2003 and D.Lgs. no 344/2003

fact, Italian SMEs who operate abroad upgrade their financial information systems only to communicate with their foreign shareholders.

Thus, while for larger Italian companies the internationalisation process has improved disclosure towards stakeholders, for smaller Italian companies this change is not yet confirmed. This low level of information is mainly due to the fact that most international partnerships are still non-long term based and, consequently, there is neither need nor interest in developing the communication process to improve trust between the two parties. Furthermore only a few Italian SMEs are involved with foreign providers of finance, which are the most interested in obtaining the company's financial reporting.

The upgrading of Italian SMEs financial reporting

In our opinion, the usefulness of financial reporting is not the same for SMEs belonging to different countries, for they are characterised by different environmental factors.

Focusing on the Italian case, not only are users of SME financial reporting different from those of large and listed companies, but International Accounting Standards for SMEs could be also too complex for a large part of Italian SME financial reporting prepares.

Considering our empirical findings, Italian small entrepreneurs today are still unwilling to disclose information to external users because they consider it a breach of privacy, and they consider such information disclosure inconvenient in their relationship with the firm's stakeholders.

Only the following exceptions have to be noted from our previous surveys: SMEs upgrade their financial information system in order to communicate with venture capitalist investors (Paoloni *et al.* (2003)). This is due to the fact these stakeholders have the power to influence the supply of information by Italian SMEs, and their information needs are much greater than those satisfied by traditional external financial accounting methods.

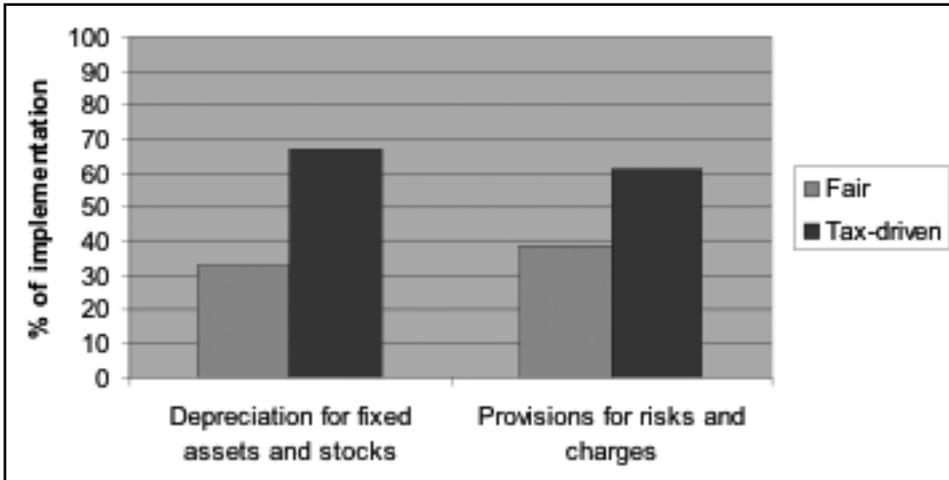
In the following years, as a result of the "Basilea 2" agreement, it is reasonable to presume that Italian SME financial reporting will be no more predominantly tax-driven. This due to the fact that whether best small entrepreneurs want to reduce the cost of lending, they have convenience to show a true and fair view of their net worth and financial position.

But at the moment it must be noted that this is only a presumption, because our latest findings (Demartini *et al.* (2005)) reveal, in practice, that not all small entrepreneurs are keen to move from a tax-driven attitude to a fair one. Less than 40% of respondents, in fact, declare that moved from tax-driven to "fair" accounting measurements after the Italian legal reforms (see fig. 2).

These results show that until there will not be a change in the small entrepreneurs attitude towards financial communication together with ade-

quate economic reasons, the aim of the Legislator is not enough to improve, in practice, SMEs financial reporting.

Fig. 2 - Accounting measurement by Italian SMEs in 2004/2005



Source: Demartini et al.(2005)

After a general discussion, we must emphasise that there is a sector that is involved more then others in future challenges above described. The sector more involved in this process is the tourist sector.

7.2. Accounting standards for Italian SMEs in tourism sector

In this paragraph, we analyze the state of art of IAS/IFRS implementation in small and medium sized Italian tourist enterprises, especially in companies that organize and are intermediaries in selling tourism packages, such as tour operators and travel agencies. We will try to reflect on their evolution and, where possible, how they are involved in relationships among SMEs and IAS/IFRS.

The interest to analyze this subject originated from studying a tourist SME that used IFRS only to “purify” financial statement from tax influences. In that case, the enterprise demonstrated its empirical interest on IFRS beyond Italian law exclusion of IFRS application in their abridged financial statement.

Several questions are therefore raised by this anecdote; among those, the first is whether the enterprises aggregation trend remains in the tourist sector. This is an important element which increases enterprise dimension and makes IAS/IFRS potentially useful.

The latter is related to the same nature of tourist enterprises, that are orientated to act on the market all over the world, and that their substantial

internationalisation requires immediate compulsory financial statements to face market competitiveness and more stakeholders' transparency.

Another element is what is happening about IAS/IFRS evolution and the successfully application of them in SMEs.

In the last few decades, organization and intermediation activities are less separated, despite remaining substantially different. Organization and intermediation activities are often carried out within the same enterprise, but following a 2001 tourist reform law, different activities require different licences.

At present, following the opinion of tourist sector experts, Italian tourist packages and intermediation market look like "spots on a leopard", along with huge barriers towards entering the market.

Only recently have we faced a problem of major collaboration and coordination between enterprises of the same category. In two categories of enterprises, in fact, data confirm that there are more than 10.000 points of sale and 400 of tour operators in Italy. There is no coherent central planning in tourist sector yet, which although in line with with a tourist development model, falls at the low end as they are proceeding slowing in this regard (Benin (2004)).

Another interesting subject is accountability transparency; one questions whether it is at the same time higher than in other sectors. If we look though the material, all enterprises are oriented to communicate not only complete financial information, but also complete social information.

Viewing the empirical research, we faced the same problem referring to a different SMEs' culture. In fact, we note that IAS/IFRS for SMEs is gospel – it is discussed by many professors and big enterprise consultants. As usual, the scholars understand trends first, and they try to convey to others a language that is too technical to understand the future. We think these reflections require the closure of dialogue, and it is difficult to convince enterprises that is an important subject.

The IAS/IFRS subject is only one of signals, which in our opinion, sheds light on a larger and more complex phenomenon such as globalization and economic interdependence.

We may think that IAS/IFRS is only one expression of the hegemonic trends of the big auditing societies, or that it is a professionals' «vice» that allows them to raise their own wages (Di Pietra (2005)).

Also in that case, we understand that European law is going without a doubt to accepting IAS/IFRS as standard for all enterprises (Mošnja-Škare (2005)). So in the tourist sector, aggregation trends and tourist complexity require, step by step, a deep reflection about the enterprise's mission, governance and accountability, but specifically orientated to tourist enterprises, it also must include the perspective dimension, too. We therefore verified what is happening in tourist SMEs IAS/IFRS' implementation, and we

found best practices such as those of Rimini Kondor tour operator, a small enterprise but one that is implementing IAS/IFRS starting from tributary aspects. We discovered a complete indifference about their implementation, which mirrored the results obtained from the study that underlined indifference and the relevance of the absence of a compulsory law to motivate IAS/IFRS implementation.

8. Some guidelines for the future

Guidelines for the future of Croatian, Italian – and, in a broader view – for European SMEs, are hereby presented.

Considering the three most highly influential processes on the implementation of accounting standards in Croatian SMEs: the adoption of a new Accounting Act, European accounting development flows, and IASB's activities on accounting standards for non-publicly accountable entities, it seems that IASB's project, once it is over, would probably be the guideline for further Croatian SMEs accounting developments. Such a solution would certainly contribute to business transparency and efficiency in SMEs, serving to further international accounting harmonization goals, but it will not reflect the particular needs, culture, tradition, professional development, market, and total economic development level, and environmental factors of Croatian SMEs. This was recognized by the ISAR group of experts, who pointed out the importance of considering the SMEs' specific accounting needs in developing countries, as well as in countries in transition, during the process of simplifying the disclosure and presentation, and recognition and measurement principles of IFRS. The standards that would be easily understandable, simple, user-friendly, and capable of producing truthful information relevant to decision-making, would be the mission that should change that «mandatory burden» approach to accounting in Croatian SMEs. That's why Croatian Financial Reporting Standards Board has decided to develop Croatian accounting standards for SMEs in accordance with EU accounting regulation requirements and IFRS with the project deadline set up for the third quarter of 2007 (Tadijančević, (2006)). On the other hand, it's questionable if a small country in transition could afford that goal, given the rushing flows of globalization and intensifying harmonisation pressures.

In Italy, considering empirical evidence, we may observe that the majority of SMEs is not ready to introduce IAS/IFRS, despite the fact that there is a great presence of very highly internationalised SMEs, because currently there are no economic factors pushing them in that direction. Thus, compulsory introduction of IAS/IFRS would create another administrative burden for Italian SMEs.

This does not mean that it is not necessary to improve the financial accountability of Italian SMEs, for example, by clearly shifting from financial reporting to formal tax filing. In this upgrading process, banks would be in the very important position to qualify SMEs' financial communication. Academics and professional accountants could also play a similarly important role in developing accounting competence among the young Italian small entrepreneurs and their staff.

Focusing on accounting harmonisation process and implementation of IAS/IFRS for European SMEs, we must consider several aspects that are all important.

Some researchers encourage pushing SMEs' implementation of the IAS/IFRS process, because they find it a useful way to increase the use of financial statements both as instruments for accountability and as instruments for management control. In fact, SMEs do not have at their disposal many management tools, and IAS /IFRS implementation could provide relevance to the financial statement such as a management tool.

Furthermore, others emphasize the importance of a unitary corpus of International Accounting Standards for all firms, which is independent from their dimension, in order to safeguard comparability.

In conclusion, our opinion is that accounting harmonisation should not consider SMEs completely apart from larger enterprises, but it must also take into account that the present corpus of IASB standards is too complex to be immediately and fully implemented by most European SMEs.

We therefore suggest that the accounting harmonisation process should not be considered apart from environmental harmonisation process (institutional, economic and cultural ones). For small businesses, as an example, the EU Government should consider, as a primary issue, harmonisation in the following fields:

- small business corporate governance law,
- corporation tax law,
- financial market for small businesses,

in order to create the conditions for a suitable harmonisation in the financial reporting of such a kind of firms.

We do not forget that Europe is also an important homogeneous "cultural phenomenon," and that European values are broadly diffused. This contributes to strengthening a platform of common thinking upon which we can also place accounting harmonisation.

We therefore agree that a progressive and continuous accounting harmonisation process must be undertaken together with environmental harmonisation processes.

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Riassunto

Questo studio analizza i conti annuali delle piccole e medie imprese (PMI), confrontando due paesi Europei: la Croazia e l'Italia. Paesi caratterizzati da fattori ambientali di natura politico-istituzionale ed economica ben differenti. In sintesi, la Croazia è un Paese che affronta le sfide di una economia in transizione, l'Italia, pur facendo parte dei Paesi dell'Occidente più sviluppati deve fronteggiare in questi anni un forte rallentamento della crescita del PIL.

Le indagini empiriche, svolte nei due Paesi, sottolineano le peculiarità del bilancio delle PMI alla luce dell'analisi dei "costi-benefici" prodotti dall'informazione contabile.

Le problematiche affrontate dalle PMI sono analizzate considerando sia la rilevanza dei fattori ambientali che caratterizzano le due Economie, sia gli effetti del processo di internazionalizzazione in atto e della volontà politica di promuovere l'armonizzazione contabile Europea.

Il nostro studio vuole essere un contributo al dibattito scientifico in corso sugli effetti dell'applicazione dei principi contabili internazionali (IAS/IFRS) alle PMI, sia per le sue considerazioni teoriche che per le evidenze empiriche riportate.

Abstract

This study analyses the financial reporting problems of small and medium-sized enterprises (SMEs) located in two European countries – Croatia and Italy, reflecting different institutional and economic environments of a transitional economy and developed economy in stagnation. The survey explores the peculiarities of SMEs accounting from the cost/benefit aspect of accounting information, pointing out their specific needs comparing to the large entities. The SMEs accounting problems are analysed in the light of environmental factors, internationalisation process and under the pressure of accounting harmonisation goals.

Thus, our contribution is a survey, by theoretical and empirical point of view, on International Accounting Standard (IAS/IFRS) applicability to SMEs, which is one of the most important topics of the current international debate among accounting scholars and professionals.