

# **PERSPECTIVES OF HARMONIZATION OF ACCOUNTING IN SMALL AND MEDIUM ENTERPRISES: THE EFFECTS OF INTERNATIONAL ACCOUNTING STANDARDS AND OF BASEL 2**

## **PERSPECTIVELE DE ARMONIZARE A SITUAȚIILOR FINANCIARE ALE IMM-URILOR, PRIN PRISMA STANDARDELOR INTERNAȚIONALE DE RAPORTARE FINANCIARĂ IAS/IFRS ȘI ACORDULUI BASEL 2**

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**Abstract.** *The aim of this research is to identify the real disclosure needs for Small and Medium size Enterprises investigating the reasons that could lead to a rise in the disclosure other than juridical ones (in particular, fiscal obligations and state financing).*

*Many recent academic researches show an increasing interest toward SMEs, both for their relevance into the national economic system, as for their specific features in terms of ownership structure, skills in fund raising, corporate governance models and financial disclosure.*

**Rezumat.** *Obiectivul acestei lucrări este acela de a înțelege care sunt exigențele efective de comunicare a întreprinderilor mici și mijlocii, investigând motivațiile care pot sta la baza implementării unui sistem informațional transparent, dincolo de exigențele juridice, în special cele cu privire la obligațiile fiscale și accesul la instrumentele de finanțare preferențiale, pentru a putea prezenta care sunt beneficiile rezultate de aici. Mai multe cercetări recente pe plan internațional prezentau un interes crescut al specialiștilor față de IMM-uri, atât în ceea ce privește contribuția lor în contextul național, dar și pentru particularitățile lor din punct de vedere al structurii proprietății, accesul la sursele de finanțare, modelelor de guvernață și “disclosure”.*

Basle 2 agreement pushes international SMEs, predominantly family business, towards wider and deeper accounting information, in order to make the banks able to value their real economic conditions for loans.

In other words, we will try to understand how and with what intensity this change will affect SMEs behaviour regarding the degree of transparency in accounting information, to obtain the concession of credit from the banks.

The research group will examine, therefore, the impact that the prospective introduction of international accounting standards for SMEs could have on their external financial communication and on their ability to obtain credit with the introduction of Basle 2.

## **MATERIAL AND METHODS**

The aim of this research article is to understand the real disclosure needs, the rules and the models for SMEs financial disclosure and auditing's systems, to estimate the adaptability of many instruments of business economic analysis for grater enterprises to SMEs – as well as IFRS, IAAS, CoSO Report - and to examine its potentials impacts on financial disclosure. The group of research will elaborate possible solutions interacting with national and international standards setters.

## **RESULTS AND DISCUSSIONS**

The necessity to create effective instruments for small and medium size enterprises is felt in a strong way since the SMEs external information has become object of important attention in the international harmonization process by the IASB that, in the 2004, has emitted a Discussion Paper to collect opinions and to evaluate the opportunity of accounting standards for SMEs and its possible role which standard setter in this field ,and by the Basil 2 agreement. In particular, the sub-objectives of this research are the followings: The analysis, therefore, will be concentrated on the characteristics of the internal and external auditing systems implemented in the great enterprises to propose a possible model of internal and external auditing systems for SMEs.

This analysis will be concentrated on the aspects that engrave on the competitive and development opportunities both SMEs and advisers and auditors ("small practitioners"), considering the costs generated from the necessities of adjustment of the internal control and auditing systems. It will make particularly reference to the United States, where the Sarbanes-Oxley Act has deeply modified the internal control systems and the responsibilities of enterprises and managers, and to the United Kingdom, that constitutes a benchmark for the governance and reporting mechanisms.

Estimating in specific way, in the light of the outcomes of the comparative analysis of such different international reality, the main points of weakness of the accounting standards, auditing standards and the models of control finding during the research. The attention will be paid on the functional interdependence between these last ones, to evidence the elements of convergence and those of dyscrasia, and also the possible solutions to obtain models and rules by wich SMEs could pick the propulsive thrust to the increment of competitiveness supported by the international contingency.

Although the phenomenon has international importance, the experience of National SMEs may be considered a particularly significant reference in order to understand, explain and analyze the phenomenology in general, the informative issues (economic and financial communication) and the control (including the auditing). On the other hand, it cannot be overlook that the control systems are been born and developed in the countries of Anglo-Saxon matrix. From that the interest in analyzing the state of the art of the control activities that put into effect in small and medium entities of other countries. The substantial insufficiency of

international literature on the SMEs will give indispensable to uses mechanisms of direct contact with academics and organizations of these countries, to integrate the theoretical-general understanding of the studied phenomena with the experience.

Hence, financial reporting of SMEs seems to be strongly influenced by the "family effect" reducing both its internal and external communicational skills. Recently, it has been pointed out how, also from an historical perspective, family firms' financial statements have been tailored according to the owners' needs and their accounting knowledge (Mussolino, Pugliese, Viganò, 2004), pointing out the necessity of a more suitable individualization of economic amounts and events that mainly concern the stakeholder of the SMEs.

An important attention to the phenomenon is present in traditionally more sensitive to the requirements of the greater enterprises countries: the United States (in the 2000 there are SME's 21 million) and the United Kingdom (in the 2003 there are SME's two million). (IAPC, 1989; APB, 1996).

About 1970s, the American Institute of Certified Public Accountants instituted a board (Committee on Generally Accepted Accounting Principles for Smaller and/or Closely Held Businesses) to investigate the "standard overload" matter, trying to find out an alternative solution to the high number of rigid and too detailed rules also issued to both Big and Small-Medium-sized Entities. Later, the Financial Accounting Standard Board – who established a special board (called Small Business Advisory Committee, SBAC) – often took part in this debate many times issuing specific accounting documents in order to reduce the informational costs for different typology of firms.

Indeed, after the introduction of the International Financial Reporting Standards as principal accounting source for UE listed companies, the International Accounting Standard Boards has a great interest to extend its accounting standards to the European Small and Medium-sized Enterprises in order to strengthen its position in this large market. On the other hand, there is a strong demand for an accounting harmonization through the IASB documents not only for the listed companies but also for the Small and Medium-sized Enterprise financial enterprises.

In this way, it would increase competitive abilities of SMEs being comparable with greater dimensions enterprises thanks to international generally accepted principles (simplified for SMEs), not only against the companies of equal dimension but also and above all with the great enterprises, in sector level and in to take up a loan.

The maintenance of a renewed competitiveness is tied up to the reliability of the information that the enterprise supplies to stakeholders.

Such reliability is assured by the role carried out by the internal and external control systems that, in their development, have widened their range with processes addressed to assure the effectiveness and the operating efficiency of the enterprise and the individuation of errors or fraud. (Root, 1998; Baraldi, Shovel, Zanigni, 2004; Comoli, 2002; Salvioni, 2004; Tettamanzi, 2003; Zanda, 2002).

From here the interest on how these control systems, created and developed in the countries of Anglo-Saxon matrix and modelled on the characteristics of the great enterprises, are suitable to SMEs, on how much they are open to influence from the introduction of new accounting standard or on how much they would be affected by the implementation of the harmonization process.

At international level, the IAASB (International Auditing and Assurance Standards Board) is discussing within IFAC (International Federation of Accountants), on the standard adaptation to the requirements of small audit practices of smaller dimensions enterprises. The currently practiced solution is the insertion guidance in every standard. The IFAC has created a permanent Task Force that sponsors the interests and the requirements of small practicing, and it give opinions to various publishes documents from the IFAC's technical committees, for example the Ethics and the IAASB. Moreover, the CNDRC's "Commission for the Audit Principles", in 2004, has approved ISA1005 "Considerations on SMEs Auditing" to the aim to evidence as the auditing in SME's demands particular considerations.

It seems useful to emphasize that the main motor of the requirement of a change in the state of the art of SMEs controls has been the Basel 2 that, fixing minimum patrimonial requirements and the coverage of various kind of risk to which the bank is exposed, emphasizes the necessity for the credit companies to adequately estimate the risk resulting from the reliability of the opposite parties (the customers) and the operating risk connected to the inadequacy of the procedures, the human resources and the internal systems.

In this way, fixing duties and engagements for the banks, the Agreement introduces considerable repercussions on the enterprises, because pondering the banking risk will fall back just on these last (customers) through instruments of rating bound to financial, economic and patrimonial requirements on which base the possibilities of access to the credit, reproposing the central position of the balance sheet and the internal and external control activities, in the within of the appreciation of the credit merit of the enterprises. (Oldani, 2004; Lenoci, 2003;)

The integrated communication takes on a new value for SMEs because, on the same conditions of default's risk, the lack of reliable information could place them in worse classes of rating with consequent possibility to increase the costs of the financings or quite to look at itself excluded from the access to the credit. These circumstances assume greater importance if we take into consideration that in some contexts, among which Italy, the undercapitalization of the enterprises and the elevated debit share supplied from the banking system confirm the problems of the existing relationship between the banks and the SMEs. Moreover, the variety and the complexity of the business risk (strategic, financial, operative, technical productive), require a structure of corporate governance, the presence of dedicated business functions, the use of appropriates methodologies of risk management (Pogliani, Valdani, Best, 2004).

Therefore in the last years, under the push of an increasing sensibility towards the topic, it has been assisted to the birth and the development of models

of internal control systems (CoSO Report, ERM) and of the activity of internal auditing (IIA, AIIA) that, operating in complementary sense to the activity of external auditing, generate sure benefits for the companies.

Therefore, the indications of Basel 2 push the companies to equip themselves with an integrated and effective approach in the surveys, evaluations and monitoring of the complex of the business risks able to supporting the timely identification of the necessary ones corrected (Doherty, 2000) to improve the handling of capital, to stabilize the profit and to guarantee to the market and to the control authorities the necessary information on the profile of risk of the company.

A different situation is more likely to be modified under the strong influences of the new accounting standards (IASB) and the "Basel 2 Agreement" which will affect both the financial statement structure and the evaluation criteria of items in the SME's financial reports.

Pressures raising from a new global market and the chance of reducing asymmetric information with external financiers (thus reducing the cost of capital) will increase the SMEs' attitude towards a financial statement as a mean of „economic” information vehicle.

## CONCLUSIONS

In conclusion, the understanding of the SME stakeholders' informational needs and an analysis of the consistency of these needs with the international accounting standards become evidently important and justify a need for a research in this field.

On the other hand, the active role of the Standard Setters in this debate is a clear sign for the importance of this paper in the management of national Firms. the European enterprises; according to the new "credit score models" of banks, pricing system of external debt will rely upon financial and economic ratios of the balance sheet and income statement However, the social-political-economical differences among European countries require some remarks about the adaptability of the International Accounting Standards to the productive situation of the European SME.

In particular, some observations have to be made on the SME national family business, as well as a change of mind about the control that in the SMEs are no more justified from the reduction of agency costs (because the Principal coincides with the Agent) and therefore must find a their own theoretical position, of the models and the rules in line with the peculiar necessities of the enterprises of smaller dimension.

It's widespread opinion that the external informative and the control system of SMEs cannot be considered just as a streamline in the accounting of the large firms. It needs to be rebuilt according to their specific features of SMEs. IASB also recognized those differences, still taking into consideration whether or not it is necessary to build up a specific accounting system for SMEs.

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