UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

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PREFACE

The United Nations has been contributing towards the harmonization of financial accounting and reporting standards for about three decades. In order to address accounting and financial reporting issues on a continuous and inclusive basis, member States established the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) in 1982. Since then, the Group has held 18 sessions.

The eighteenth session was held in Geneva on 10-12 September 2001. The main agenda item for the session was accounting by small and medium-sized enterprises (SMEs). The experts had previously identified a number of obstacles that SMEs face in maintaining accounting records and generating meaningful financial information. They established an ad hoc consultative group of 23 experts to formulate proposals for resolving these obstacles. Intensive consultations were conducted and a report was presented to the eighteenth session.

This volume of the *Review of International Accounting and Reporting Issues* contains the proceedings of the eighteenth session of ISAR. The deliberations on accounting by small and medium-sized enterprises are presented in Part 1. It also contains essays by leading experts on the implementation of international accounting standards and the current state of the international standard-setting process; The essays are presented in Part 2.

UNCTAD would like to thank all the members of the ad hoc consultative group on accounting by SMEs for their valuable contributions: Ashok Chandak (The Institute of Chartered Accountants of India), India; ChenYugui, (Ministry of Finance) People's Republic of China; Colin Fleming, (Observer - International Accounting Standards Board), United Kingdom; Eric Delesalle (Institut National des Techniques Economiques et Comptables du Conservatoire National des Arts et Métiers), France; Aziz Dieye (PricewaterhouseCoopers), Senegal; Tihomir Domazet (Ministry of Finance), Croatia; Ndung'u Gathinji (Eastern Central and Southern African Federation of Accountants), Kenya; Lyle Handfield (Certified General Accountants Association of Canada), Canada; David Harvey (The Association of Chartered Accountants), United Kingdom; John Hegarty (World Bank), United States; Peter Johnston (International Federation of Accountants), United States; Owen N. Koimburi, Kenya; Mikael Lindroos (European Commission), Belgium; C. M. Lovatt (Deloitte and Touche), Malawi; Richard Martin (Association of Chartered Certified Accountants), United Kingdom; David Moore (Canadian Institute of Chartered Accountants), Canada; Mary Ncube, Zambia; Prawit Ninsuvannakul (Chulalongkorn University), Thailand; Ricardo Rodil, Brazil; Alfred Stéttler (University of Lausanne), Switzerland; Samiuela Tukuafu (Asian Development Bank), Philippines; John Vincent (Association of Accounting Technicians), United Kingdom, and Peter Walton (ESSEC Business School), France.

Last but not least, UNCTAD would like to thank David Cairns, Secretary General of the IASC (1985-1994), Dr. Patricia Sucher (Royal Holloway, University of London) and Professor Peter Walton (ESSEC Business School) for contributing essays to this volume of the *Review*. UNCTAD would also like to extend its appreciation to the Secretariat who made this publication possible; Yoseph Asmelash, Constantine Bartel, Chedra Bullock, Roselyne Carrier, Tatiana Krylova, Dezider Stefunko and Lorraine Ruffing.

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PART 1

ACCOUNTING BY SMALL AND MEDIUM-SIZED ENTERPRISES

SUMMARY

An UNCTAD resource person, introducing the item, recalled that the mandate given to the consultative group, whose report was contained in document TD/B/COM.2/ISAR/12, had been to decide on a categorization of SMEs and a user-friendly accounting and reporting framework for SMEs and identify implementation difficulties.

Any accounting system for SMEs should be simple, understandable, and user-friendly. It should contain management information, and this was a major departure from the usual financial accounting framework, which contained information for external rather than internal users. However, ISAR had decided that the needs of SME managers should be taken into account. The system should be reconcilable for tax purposes and should take into consideration the SME environment, particularly resource constraints. The framework proposed by the consultative group was based on several assumptions, including that different-sized enterprises required different accounting rules, that rules should be aligned with resources, and that rules should be consistent with the International Accounting Standards (IAS) and their conceptual framework.

Assuming that in any economy there were many different-sized businesses and that a single accounting framework would therefore ignore economic reality, a system should be created that was internally consistent and allowed enterprises to graduate from one level to another. The consultative group proposed that enterprises be divided into three categories

Level 1: entities that issue public securities and entities in which there is significant public interest, as well as banks and financial institutions

Level 2: larger SMEs that do not issue public securities and do not prepare financial reports for the general public.

Level 3: small businesses and new entrants.

Level 1 entities would apply full IAS. Level 2 entities would apply a core set of IAS. Level 3 small businesses would do simple accruals, while new entrants would be allowed to do cash accounting for a brief period. Each country would have to define "entities in which there is a significant public interest". However, this was generally thought to refer to enterprises with a "significant" number of employees, in-house accounting skills and the potential to expand to Level 1. The dividing line between Levels 2 and 3 would have to be determined by each country according to its economic structure.

The application of full IAS might be beyond the needs of Level 2 enterprises and the costs would outweigh their benefits. These enterprises would apply an "abridged IAS" that covered most of their transactions. The speaker referred to the 80/20 rule, which states that 20 per cent of the standards cover 80 per cent of SME transactions. However, if an SME were to encounter a transaction that the "core standards" did not address, it would be required to comply with full

IAS. Level 2 enterprises would always have the option of complying with full IAS.

The consultative group felt that a condensed set of rules for smaller businesses could be particularly useful in a developing-country environment and could serve as a stepping-stone to full IAS compliance. It could be a starting point for the development of a "technician" level of accounting expertise, specifically for SMEs.

Most importantly, the consultative group took the view that the "abridged IAS" should preserve the recognition and measurement base of the full IAS, but with limited disclosure requirements. The selection process would involve first identifying those standards thought unlikely to concern larger SMEs and then identifying disclosure requirements that would not be applicable to Level 2 SMEs or could be simplified. The "abridged IAS" could eventually be a single document that would bring together the relevant elements of the "core SME standards". The speaker explained which IAS had been included and which excluded. Criteria for inclusion included frequency of use and degree of complexity.

With respect to the smallest SMEs, the consultative group was of the view that these SMEs should follow a simple accruals system that would be consistent but not fully compliant with IAS. The accounting framework would principally aim at producing useful information for management, tax officials and creditors. The speaker introduced a set of sample financial statements (presented in annex 1 of the ad hoc consultative group's report) that would fulfil the external and internal reporting needs of SMEs. These included a model chart of accounts containing a list of headings that could be used to maintain a general ledger directly linked to the main financial statements. Such a chart would allow the creation of a database that tracked transactions and complied with accounting rules and could be handled by an accounting technician. The uniform approach imposed by the use of a chart of accounts would cut the cost of training and retraining at both the enterprise and the economy levels as people transferred from enterprise to enterprise or even from country to country.

In the discussion that followed, the group of experts reviewed and deliberated on the report prepared by the ad hoc consultative group. Although most experts agreed with the general approach to accounting by SMEs proposed by the consultative group, different views were expressed about specific aspects of the suggested accounting and reporting framework. Thus, for example, some experts questioned the usefulness of a uniform chart of accounts for Level 3 SMEs. In their opinion, model ledger accounts might lead to meaningless figures and did not reflect the individual nature of an enterprise. Others stressed that model ledger accounts were desirable in order to make financial statements more comprehensible for lenders. A harmonized system would also lower costs of training and provision of software. Some experts were of the