



**A FRAMEWORK FOR
DIFFERENTIAL REPORTING**

**A RESPONSE TO ISAR'S ACCOUNTING AND
FINANCIAL REPORTING GUIDELINES FOR
SMALL AND MEDIUM SIZED ENTERPRISES**

This study was undertaken by Associate Professor Dr. S. Susela Devi of the University of Malaya (currently on sabbatical leave at the University of Waikato, New Zealand)

The mission of CAPA is to provide leadership in the development, enhancement and coordination of the accountancy profession in the Asia-Pacific region to enable the profession to provide services of consistently high quality in the public interest.

CAPA welcomes any comments or feedback you may have on this study. Comments should be sent to:

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PREFACE

It cannot be denied that the interests of Small and Medium Enterprises (SMEs) have been overlooked in the arena of international accounting standards setting. The *Framework for the Preparation and Presentation of Financial Statements*, issued by the International Accounting Standards Board's predecessor, IASC, in July 1989, clearly articulates the goal of decision usefulness as the primary objective. It focuses on the use of financial statements for investment and credit decisions. It is widely claimed that a value judgement has been made to give primacy to the decision needs of capital market participants.

It is also noted that the pace of change has been accelerating as a result of the effects of the globalisation of capital markets, revolutionary advances in information technology and in investment and risk management theories and practices, among others. There is also evidence of ever increasing influence of modern capital markets and finance theories as we witness current struggles of international standard setters with the implications of present value concepts, and with the effects of complex business transactions to debundle, rebundle and diversify risks and combine and restructure business enterprises. It is also clear that increasingly smaller enterprises are burdened with more sophisticated and complicated accounting standards which are perceived to be inappropriate for the needs of the users of financial reports of SMEs. Therein the issue of Differential Reporting arises. It is time to move forward with this debate and encourage serious discussions and explore avenues to provide solutions for smaller enterprises' accounting and reporting.

This research report has three stated objectives. The first objective is to recount in an organised manner the need for differential reporting regimes in almost all countries. The second objective is to explore the level of awareness of constituent groups of current initiatives with respect to differential reporting. The third is to evaluate the UNCTAD ISAR Guideline on SMEs – to appraise strengths and weaknesses with a view to stimulating discussion and possible improvement.

This research study was undertaken in Hong Kong during the World Congress of Accounting Educators and the World Congress of Accountants in November 2002. In-depth interviews were carried in Hong Kong to obtain feedback from the participants at these congresses. In addition, a questionnaire survey was utilised to obtain CAPA member bodies' responses to pertinent issues.

The findings from the study indicate clearly a lack of awareness among relevant stakeholder groups on the current initiatives undertaken by international organisations like UNCTAD-ISAR. However, the findings provide an overwhelming support for initiatives on *Differential Reporting*. The study articulates some important questions about the fundamental nature of the appropriateness of the IASs for developing nations and their SMEs. It calls for concerted efforts in identifying the needs of users of financial reports of SMEs. The effort by UNCTAD is applauded, for the study concludes that a first step is better than no step at all. However, the crucial finding from the study is that IASB must take ownership of this matter and deal with it as part of its mandate to provide credibility to the initiative. It is important to have a global rather than a local perspective

of the issue. Until this is done there can be no satisfactory resolution to the issue of *Differential Reporting*. The study drives the point that the lesser developed countries and their SMEs will be left lagging behind in their attempts to instill an appropriate financial reporting regime, given the pace at which IASs are advancing. In this regard, the study establishes the majority support for regional bodies, like CAPA, to play a proactive role in educating and facilitating a forum to deliberate on critical conceptual and implementation issues.

Dr. S. Susela Devi
Researcher

FOREWORD BY CAPA PRESIDENT

There has been rapid development in financial reporting, intensified by efforts towards international convergence of accounting standards, primarily driven by the globalisation of financial markets efforts and need to meet securities regulators' concerns. Whilst these developments can be justified for public companies on the grounds of public interest, applying the same financial reporting standards to all enterprises has become increasingly debatable. It cannot be denied that the proliferation of accounting pronouncements in the past few years has added complexities to the preparation of financial statements and therefore become increasingly burdensome to small business enterprises (or Small and Medium sized Enterprises - SMEs).

Concerns regarding reporting burdens imposed on small enterprises are justifiable. Given the significance of SMEs in most economies, the question as to whether smaller enterprises face disproportionately higher compliance costs relative to larger companies deserve considerable attention. What are the possibilities for differential standards – standards that are different for different classes of entity – resulting in a *Differential Reporting Regime*? This is an important question. One, which CAPA felt, is crucial to pursue in the interest of SMEs.

UNCTAD- ISAR has clearly recognised the importance of this matter and had deliberated and consulted experts from various countries and published an Exposure Draft on *Guidelines for Small and Medium Enterprises (SMEs)*. The significance of the issue is also reiterated by IFAC when it established the Small and Medium Practitioners'/Small Medium Enterprises' Taskforce. The IASB as well has initiated a Working Group to explore the relevant issues in this matter.

However, with all the initiatives being undertaken by the International bodies, it is clear that it had not stimulated sufficient debate and awareness of the issue is sadly lacking among the crucial stakeholders- regulators, profession, market and community.

Hence, CAPA commissioned this research project. CAPA believes it is vital for the accounting profession as well as other stakeholders in the financial reporting process- the government, international and national standard setters, preparers and users of financial statements - to deliberate on the topic in order to generate sufficient interest and feedback that can be useful in assisting the International Accounting Standards Board / UNCTAD-ISAR formulate appropriate guidelines for establishing a *Differential Reporting Regime*.

The Research has highlighted several pertinent issues for consideration by all stakeholder groups. The Research findings clearly support the need for implementing *Differential Reporting Regimes* in all countries. The Report identifies the key concerns that need to be resolved and has made recommendations for moving forward. This is particularly useful for CAPA member bodies and their members to evaluate their stances with respect to *Differential Reporting*.

Overall, this study articulates the critical role that CAPA, as a regional body, can play. CAPA has much to contribute in assisting the education of the users and preparers

of financial statements of SMEs so as to facilitate move towards convergence of international standards. I urge CAPA member bodies to examine this report and to identify areas where they may need to initiate further action in order to give due recognition to the SME sector which in most cases is the engine that drives most local economies.

LI YONG

President

Confederation of Asian and Pacific Accountants

EXECUTIVE SUMMARY

The report by Dr. Susela Devi discusses her findings from the exploratory research study conducted on behalf of CAPA in Hong Kong in November 2002. The report highlights the events leading to the development of differential reporting practices in some countries and explores the ISAR guidance on SMEs accounting and reporting. The perceptions of respondents in the research study provide valuable input to the feedback that CAPA can provide to ISAR on the proposed ISAR guidelines – “Accounting and Financial Reporting Guidelines for Small and Medium Sized Enterprises (SMEGA)”.

The report recommends a more comprehensive coverage of the issues mentioned in the guidelines and a more coherent framework to support the recommendations proposed in the guidelines. More comprehensive discussion on the rationale for the proposals in the individual guideline is also recommended.

In recommending the way forward for differential reporting, the report calls for intensified efforts to be directed at educating the target implementers in the respective nation states and for greater involvement of regional accountancy bodies to strengthen efforts of UNCTAD.

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