

ANALYSIS OF FINANCIAL REPORTING STANDARDS SPECIALLY DESIGNED FOR MICRO ENTITIES

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Abstract- All entities, regardless of size, are obliged to apply appropriate accounting standards in the field of financial reporting. However, the question arises to what extent existing accounting solutions meet and follow the information requirements as well as the financial capabilities of micro entities. Therefore, the paper analyses the most important provisions of A Guide for Micro-sized Entities Applying the IFRS for SMEs, Financial Reporting Standard applicable to the Micro-entities Regime and Croatian Financial Reporting Standards in order to know whether there are differences in expressing the financial position and performance of micro entities in different countries.

Index terms- micro entity, IFRS for SMEs, national financial reporting standards for micro entities

I. INTRODUCTION

Financial reporting standards are the starting point for the accounting reporting of interested external users. The rules of recognition, measurement and valuation of the most important positions of financial statements, which are defined in the accounting standards, significantly influence the accounting information about financial stability and business efficiency. It is hardly surprising how important it is to know provisions of the standards based on which the financial statements are prepared. All entities, regardless of size, are obliged to apply appropriate accounting standards. However, the question arises to what extent existing accounting solutions meet and follow the information requirements as well as the financial capabilities of those smallest entities. Therefore, the paper analyses the most important provisions of the International Financial Reporting Standards for Small and Medium-sized Entities, Financial Reporting Standard applicable to the Micro-entities Regime and Croatian Financial Reporting Standards in order to know whether there are differences in expressing the financial position and performance of micro entities in different countries.

II. APPLICABILITY OF THE IFRS FOR SMEs IN MICRO ENTITIES

Some important novelties in the field of financial reporting of small and medium-sized entities were introduced a decade ago. In this respect, it should be noted that, among others, IASB made the first steps in the harmonization of SMEs accounting regulations by reinforcing the idea about the importance of the existence of special financial reporting standards that will be recognized and applicable to a wide range of users. With that objective in July of 2009 IASB issued International Financial Reporting Standards for Small and Medium-sized Entities. These Standards are structurally relying on existing comprehensive International Financial Reporting

Standards, although some differences are visible. Primary differences are evident in the quantity which can be seen in reducing the number of pages from over 2500 to 250. Moreover, standards content is reduced by eliminating some standards that are not relevant for the typical small and medium enterprise such as the simplification of the method for recognizing and measuring the positions of the financial statements, reducing the requirement for disclosure in the notes, etc.

So far, over seventy countries have adopted IFRS for SMEs at the national level in a way that generally allow or, more rarely, require their exclusive use. Countries that have adopted these standards, predominantly accept it in full while some countries still require certain modifications in line with past domestic theory and practice of financial reporting. Geographically, it is possible to notice how generally less developed countries more often are willing to adopt these Standards. Possible reason for that can be the fact that they do not have sufficient capacity to produce their own standards or they rely on the regulations issued by the IASB in order to increase international recognition and facilitate access to foreign investment. However, it is quite interesting fact that “many developing countries are trying to embrace IFRS for SMEs in totality but the developed countries seem to be lagging behind. Clearly, this situation does create a trust gap in the confidence of using this framework in the preparation of financial statements” (Rudzani and Manda, 2016).

Table 1: Structure of A Guide For Micro-Sized Entities Applying The IFRS for SMEs (2009)

NUMBER	NAME OF THE STANDARD
Guide section 1	Intended scope of this guide
Guide section 2	Concepts and pervasive principles
Guide section 3-8	Financial statement presentation
Guide section 9	Consolidated and separate financial statements
Guide section 10	Accounting policies, estimates and errors
Guide section 11-12	Financial instruments

Guide section 13	Inventories
Guide section 14-15	Investments in associates and joint ventures
Guide section 16	Investment property
Guide section 17	Property, plant and equipment (PPE)
Guide section 18	Intangible assets other than goodwill
Guide section 19	Business combinations and goodwill
Guide section 20	Leases
Guide section 21	Provisions and contingencies
Guide section 22	Equity
Guide section 23	Revenue
Guide section 24	Government grant
Guide section 25	Borrowing costs
Guide section 26	Share-based payment
Guide section 27	Impairment of assets
Guide section 28	Employee benefits
Guide section 29	Income tax
Guide section 30	Foreign currency translation
Guide section 31	Hyperinflation
Guide section 32	Events after the end of the reporting period
Guide section 33	Related party disclosures
Guide section 34	Specialised activities
Guide section 35	Transition to the IFRS for SMEs

EXTENT ~ 99 pages

Source: IFRS Foundation (2013) A Guide For Micro-Sized Entities Applying The IFRS for SMEs (2009). Available at: <http://www.ifrs.org/IFRS-for-SMEs/Documents/A-Guide-for-Micro-sized-Entities-2013.pdf> (14.10.2016.)

These Standards are applicable for micro-enterprises according to IASB. To facilitate the understanding of them in 2013 “A Guide for Micro-sized Entities Applying the IFRS for SMEs as issued in July 2009” was released. It is important to note that it is not a separate Standard for micro entities and its primary intention was to help micro entities to identify more easily the requirements of the IFRS for SMEs that are relevant to them. (IFRS Foundation, 2013). Its structure and content can be seen in Table1. The main question is whether IFRS for SMEs are applicable to micro-sized entities indeed. It is understandable that each standard will not be equally important in different entities depending on the size as well the industry. Some authors (Neag, 2010) believe that “IFRS for SMEs may still be considered too complex for micro-entities because many of the requirements will not be applicable for entities with a more simple business model.” On the other hand “it was found that small businesses in some countries have limited international structures and activities which do not result in a need for internationally comparable financial reporting information” (Aboagye-Otchere and Agbeibor, 2012).

III. BASIC CHARACTERISTICS OF FINANCIAL REPORTING STANDARDS APPLICABLE TO THE MICRO-ENTITIES REGIME IN UK

The accounting system of the United Kingdom is regulated by the Company act (Company Act, 2006 and Companies, Partnership and Groups (Accounts and Reports) Regulations 2015). In the UK, micro and small entities in preparing and presenting financial statements apply the national UK GAAP (Generally Accepted Accounting Principles of the United Kingdom) that emerged as result of harmonization of national legislation with the provisions of Accounting Directive 2013/34/EU. UK GAAP's are composed of six financial reporting standards:

- FRS 100 - Application of Financial Reporting Requirements,
- FRS 101 - Reduced Disclosure Framework,
- FRS 102 - The Financial Reporting Standard applicable in the UK and Republic of Ireland,
- FRS 103 - Insurance Contracts,
- FRS 104 - Interim Financial Reporting,
- FRS 105 – The Financial Reporting Standard applicable to the Micro-entities Regime.

For more detail on standards see:

<http://www.icaew.com/en/technical/financial-reporting/new-uk-gaap>). While all the other Financial Reporting Standards are in force since the beginning of 2015, only FRS 105 - Financial Reporting Standards Applicable to the Micro-entities Regime is in force since 01.01.2016.

United Kingdom was one the first countries that recognized the special needs of small compared to larger entities. About two decades ago, UK issued special Financial Reporting Standards for Smaller Entities (FRSSE) which was used as a framework for financial reporting of smaller companies until recently. It is one of the first countries in the EU, along with Germany, that has included "micro option" in the national accounting system. From the implementation of so-called "Micro directive" (2012/6/EU) until today there have been made certain changes in the national regulations. Certainly the most significant change was the withdrawal of Financial Reporting Standards for Smaller Entities (FRSSE) and the publication of a new financial reporting standards applicable to micro enterprises (FRS 105 - The Financial Reporting Standard applicable to the Micro-entities Regime) in 2015.

Table 2: Structure of the FRS 105 (2015)

NUMBER	NAME OF THE STANDARD
FRS 105-1	Scope
FRS 105-2	Concepts and Pervasive Principles
FRS 105-3	Financial Statement Presentation
FRS 105-4	Statement of Financial Position
FRS 105-5	Income Statement
FRS 105-6	Notes to the Financial Statements

FRS 105-6	Notes to the Financial Statements
FRS 105-7	Subsidiaries, Associates, Jointly Controlled Entities and Intermediate Payment Arrangements
FRS 105-8	Accounting Policies, Estimates and Errors
FRS 105-9	Financial Instruments
FRS 105-10	Inventories
FRS 105-11	Investments in Joint Ventures
FRS 105-12	Property, Plant and Equipment and Investment Property
FRS 105-13	Intangible Assets other than Goodwill
FRS 105-14	Business Combinations and Goodwill
FRS 105-15	Leases
FRS 105-16	Provisions and Contingencies
FRS 105-17	Liabilities and Equity
FRS 105-18	Revenue
FRS 105-19	Government Grants
FRS 105-20	Borrowing Costs
FRS 105-21	Share-based Payment
FRS 105-22	Impairment of Assets
FRS 105-23	Employee Benefits
FRS 105-24	Income Tax
FRS 105-25	Foreign Currency Translation
FRS 105-26	Events after the End of the Reporting Period
FRS 105-27	Specialised Activities
FRS 105-28	Transition to this FRS
EXTENT	~ 128 pages

Source: Financial Reporting Council (2015) FRS 105, available at: <https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-105-The-Financial-Reporting-Standard-applicab.pdf> (15.10.2016.)

FRS 105 is a standalone set of 28 financial reporting standards (Table 2) designed for micro entities but only if they decide to apply them. The micro entities in the UK have the option of selecting the application of:

- (1) FRS 102 which is adapted to small and medium-sized enterprises based on IFRS for SMEs or
- (2) FRS 105 that further simplifies the methods of recognition and measurement of elements of financial statements as well as the overall financial reporting of micro entities.

These two sets of standards are completely independent sets of financial reporting standards and therefore principle of consistency should be applied. In accordance with FRS 105, micro entities should apply accrual principle in the preparation of financial statements. For them, a set of financial statements includes a statement of financial position that involves some notes in its foot, and the income statement. In addition to the exemption from the preparation of the notes, United Kingdom has adopted a requirement that fair value is not used in the financial reporting of micro entities. Moreover, micro enterprises are not allowed to revalue nor measure its assets or liabilities at fair value. These changes came into force with the beginning of 2016, although earlier application was allowed.

IV. STRUCTURE AND CONTENT OF CROATIAN FINANCIAL REPORTING STANDARDS FOR MICRO ENTITIES

Accounting Act regulates the entire accounting of entrepreneurs in the Republic of Croatia. Among other things, it defines the framework for financial reporting depending on company's size. Until ten years ago, the national accounting system was unified in the terms of the application of uniform accounting standards (International Accounting Standards and International Financial Reporting Standards) for all companies regardless of their size. By adopting Accounting Act at the end of 2007 and in particular by the publication of national accounting standards Croatian national financial reporting system gets new features.

The most significant simplification of the financial reporting regulative, in the context of small and medium-sized entities, was achieved in 2008 by introducing a mandatory application of national Croatian Financial Reporting Standards (CFRS). They were made for all those companies that are not considered large and whose shares or debt securities are not included (neither is the process of listing the securities on the stock exchange in progress) on the organized securities market. Croatian Financial Reporting Standards are adjusted to the needs of medium-sized, small and micro entities that predominate in the Croatian economy. They are based on the national accounting theory and practice, but at the same time, they meet the requirements of European Union regarding drafting, presentation and disclosure of financial statements. This means that measurement and recognition criteria are harmonized with provisions of Directive 2013/34/EU (CFRS, NN 86/15). Financial reporting of small and medium-sized entities is regulated through a total of 17 standards that individually process the most important position of financial statements (Table 3).

In 2015, a new Accounting Act (Official Gazette No. 78/15) was issued and it was aligned with the requirements of Directive 2013/34 / EU. The new Law for the first time introduces the term micro entity in the national system of financial reporting. However, in terms of the obligations and rights these companies are equalized with small ones. This means that for the smallest companies not even one simplification has been introduced. Consequently, that means that micro, small and medium-sized entities in Croatia are obliged to prepare three financial statements. These are balance sheet, profit and loss account and notes to the financial statements (Accounting Act, NN 78/15) and they should be drawn up on an accrual basis. When measuring elements of the financial statements micro, small and medium-sized entities can use the following methods of measurement: cost (cost of purchase), current cost, realizable (marketable) value, present value and fair value. The structure of the balance sheet and profit

and loss account, particularly in the terms of form adopted for their presentation, may not be changed from year to year which corresponds to adequate application of the consistency principle. In addition to the above principles, entrepreneurs who apply Croatian Financial Reporting Standards are required to respect and the follow some of the general financial reporting principles: going concern principle, principle of materiality, comparability principle, offsetting, balance continuity - the opening balance sheet, prudence and others (CFRS, NN 86/15).

Table 3: Structure of the CFRS (2015)

NUMBER	NAME OF THE STANDARD
CFRS 1	Financial Statements
CFRS 2	Consolidated Financial Statements
CFRS 3	Accounting Policies, Changes in Accounting Estimates and Errors
CFRS 4	Events after the end of the reporting period
CFRS 5	Long-term intangible assets
CFRS 6	Long-term tangible assets
CFRS 7	Investment Property
CFRS 8	Non-current assets held for sale and discontinued operations
CFRS 9	Financial assets
CFRS 10	Inventories
CFRS 11	Receivables
CFRS 12	Equity
CFRS 13	Liabilities
CFRS 14	Accruals and Deferrals
CFRS 15	Revenues
CFRS 16	Expenses
CFRS 17	Agriculture
EXTENT	~150 pages

Source: CFRS, Official Gazette 86/2015. Available at: http://narodne-novine.nn.hr/clanci/sluzbeni/2015_08_86_1709.html (15.10.2016.)

V. RESULTS OF THE COMPARISON OF SELECTED FINANCIAL REPORTING STANDARDS FOR MICRO ENTITIES

Before drawing conclusions about the compliance of the most important standards for micro entities, it is interesting to compare the definition of micro entities that need to apply a specific set of standard. Based on the analysis presented in Table 4 it is possible to assess whether there are differences in determining the micro entity that need to apply concrete Standard. Therefore, mentioned fact should be kept in mind when comparing the content of the standards.

Table 4: Differences in defining micro entity who should apply concrete set of financial reporting standards

FINANCIAL REPORTING STANDARD	DEFINITION OF MICRO ENTITY
A Guide For Micro-Sized Entities Applying The IFRS for SMEs (2009)	SMEs are all entities that publish general purpose financial statements for external users and do not have public accountability. Micro entity is a very small entity with simple transactions and normally: (a) has few employees and is often owner managed; (b) has low or moderate levels of revenue and gross assets and (c) does not have investments in subsidiaries, associates or joint ventures; hold or issue complex financial instruments; or issue shares or share options to employees or other parties in exchange for goods or services
Financial Reporting Standard 105 (2015) (1 £ = 1.11 €)	Micro entity is defined as one that does not exceed two of the following three criteria: (1) number of employees: 10 (2) total assets: 350.760 € (3) total revenues: 701.520 €
Croatian Financial Reporting Standards (2015) (1 HRK = 0,133 €)	Micro entity is defined as one that does not exceed two of the following three criteria: (1) number of employees: 10 (2) total assets: 345.800 € (3) total revenues: 691.600 €

Source: Authors according to: IFRS for SMEs, A Guide for Micro-sized Entities Applying the IFRS for SMEs (2009),

<http://www.icaew.com/en/technical/financial-reporting/other-reporting-issues/companies-act/micro-entity-accounts-exemptions> (15.10.2016.) and Croatian Accounting Act, NN 78/2015

As it can be seen there are differences in defining micro entity between analyzed set of accounting standards. While IFRS for SMEs define micro entity on a qualitative basis, Financial Reporting Standard 105 and Croatian Financial Reporting Standards will be applicable in those entities whose assets and income do not exceed the required criteria. This means that micro entity is defined quantitatively. Only the "number of employees" criterion is similar to all analyzed financial reporting standards.

Accounting directive 2013/34/EU affects the financial reporting of micro-enterprises in EU Member States. Since the new accounting directive was modernized on the principle of "think small first" there are available many simplifications for this group of economy. Regarding the application of IFRS for SMEs it is important to highlight the fact that the European Commission did not accept this set of standards as a generally accepted set of financial reporting standards for SMEs at EU level. However, in the framework of EU Directives each country has

the option to apply national accounting standards for all those companies that are not quoted on the stock exchange and do not prepare consolidated financial statements. The research of financial reporting practices in the EU shows that some Member States, where the United Kingdom is certainly surpassing the others, utilized the possibility of exempting small entities from certain financial reporting obligations in order to enable the reduction of financial reporting costs. On the other hand, for now, simplifications of regulations in Croatia that would apply only to micro entities is not recognized yet. Micro entities have the same simplifications that they previously had when they were categorized as small entities.

Standards of financial reporting affect the quality of financial statements, and thus the assessment of financial position and financial efficiency of the business. As an illustration, the same entity with the use of one set of accounting standards may express higher profits while the application of the second set, due to the inability of capitalization of certain costs, will show a lower level of realized business results. In this regard, it is useful to compare the structure and content of the accounting standards applicable to micro entities. If we analyze the structure of individual standards, it is evident that the IFRS for SMEs and FRS 105 are similarly structured. As opposed to them, Croatian Financial Reporting Standards are structured according to the basic balance sheet categories. One can also notice how FRS 105 and IFRS for SMEs regulate financial reporting of micro entities by numerically more individual standards (35 and 28) as opposed to the CFRS (17). According to all standards, a micro entity shall prepare its financial statements using the accrual basis of accounting, which means that items are recognized as assets, liabilities, equity, income or expenses when they satisfy the definitions and recognition criteria for concrete item. Very often, the question of whether the application of the fair value concept for the smallest companies is necessary arises especially if one knows that the fair value estimates is not simple nor inexpensive task. Necessity of exempting micro entities from using fair value in financial reporting can be confirmed by the fact that almost no one uses this option. In the Republic of Croatia the application of this concept is still permitted while IFRS for SMEs and FRS 105 have adopted a requirement that micro entities do not use fair value for financial reporting of micro entities i.e. they are not permitted to revalue or subsequently measure assets or liabilities at fair value.

As for the set of financial statements that micro entities shall present, the broadest set is included in the IFRS for SMEs while FRS 105 defines the narrowest range of financial statements. According to A Guide for Micro-sized Entities Applying IFRS for SMEs (IFRS Foundation, 2013) a complete set of

financial statements of an entity shall include all of the following:

- (a) a statement of financial position showing the entity's assets, liabilities and equity as at the reporting date;
- (b) a statement of income for the reporting period, displaying all items of income and expense recognized during the period;
- (c) a statement of changes in equity for the reporting period. The statement of changes in equity presents a reconciliation between the carrying amount at the beginning and end of the period for each component of equity. However, if the only changes to equity in the current period or any comparative period presented in the financial statements arise from profit or loss, payment of dividends, corrections of prior period errors and changes in accounting policy, the entity may present a single statement of income and retained earnings in place of the statement of income and statement of changes in equity;
- (d) a statement of cash flows for the reporting period which provides information about the changes in cash and cash equivalents of an entity for a reporting period and
- (e) notes, comprising a summary of significant accounting policies and other explanatory information in addition to that presented in the above mentioned statements.

In Croatia, Accounting Act (NN 78/15, 134/15) defines which financial statements micro entity shall prepare:

- (a) a statement of financial position which is known as balance sheet;
- (b) a profit and loss account and
- (c) notes to the financial statements.

According to FRS 105 (Financial Reporting Council, 2015) a complete set of financial statements of a micro-entity shall include:

- (a) a statement of financial position as at the reporting date with notes included at the foot of the statement and
- (b) an income statement for the reporting period.

International solutions delivered by the IASB directly or indirectly affect the financial reporting of countries around the globe, including the UK and the Republic of Croatia. The main goal of the paper was to investigate if there are substantial differences of the most important provisions of the IFRS for SMEs, FRS 105 and CFRS. According to Table 5 it can be seen that the differences exists but they are not significant. The only difference is visible in the possibilities of capitalization of borrowing costs and development costs while other segments are harmonized and some major essential difference actually does not exist. In the new revised IFRS for SMEs (2015) there has been some changes and the most important is that application of the revaluation model in subsequent valuation of tangible assets is now available for property, plant and equipment (IASB, 2015).

Table 5: The most important differences between analysed set of accounting standards for micro entities

ACCOUNTING TREATMENT	IFRS for SMEs	FRS 105	CFRS
capitalization of borrowing costs	no	no	yes
measurement after initial recognition of the tangible and intangible assets	cost model revaluation model (only for property, plant and equipment)	cost model	cost model revaluation model
capitalization of development costs for intangible assets	cost model	cost model	cost model capitalization model

Source: IFRS for SMEs, FRS 105 and CFRS

CONSLUSION

The provisions of the accounting standards define the quality of the financial statements. Depending on the rules of recognition and measurement of financial statement elements, defined in the financial reporting standards, the expressions of the financial position and business performance can be different. This fact significantly affects the financial position and business performance of an entity. The paper compared three sets of financial reporting standards that are used for micro entities. Results of the analysis show that there is a high level of compliance of these three regulations but there are some differences. Difference is visible in the possibilities of capitalization of borrowing costs and development costs for internally generated intangible asset, which is allowed only in Croatian Financial Reporting Standards. This means that financial result could be little bit higher if an entity applies CFRS instead of IFRS for SMEs or FRS 105. Since these costs are not usually significant for micro entities, it can be said that there will be no differences in the expression of final earnings. Finally, it should be noted that the obligations in the field of financial reporting of micro entities is the lowest for those entities operating in the UK (micro entity in the UK should prepare only two financial statements) while they are highest for companies using IFRS for SMEs (those micro entities

need to prepare a complete set of five financial statements).

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