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**Financial Statements of the SMEs and their
Role in Providing the Security of Business
Transactions**

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Financial Statements of the SMEs and their Role in Providing the Security of Business Transactions

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Abstract

Small and medium enterprises are a crucial element of the European economy, which is confirmed by statistical data, according to which such companies constitute 99% of all the enterprises in the European Union, employ two thirds of all the people employed in the enterprise sector and have a significant share in GDP as it amounts to 60%.

The increasing globalization and the development of the information and communication technologies result in the growing number of business partners an average enterprise will have and consequently in the bigger number of commercial transactions completed. These transactions will be carried out at a distance more often. The degree financialization of the economy also increases. Commercial transactions are always accompanied by a certain risk which contractors try to minimize by analyzing the economic and financial standing of their business partners. The financial statements of its business partners have a crucial role in this process. These reports present the assets and financial condition of an enterprise as well as its financial results and because of that they become kind of an identity document for a company. Decisions based on such analysis are right as long as the financial reports are reliable and integrity prepared. The European Commission noticed this problem and it introduced International Financial Reporting Standards and International Financial Reporting Standards for SMEs.

Small and medium enterprises should prepare their financial statements - in accordance with the national or international standards. The international standards are more laborious but they are easier to compare by foreign contractors. On the other hand they give a chance to establish wider business contacts. The decision on which entities are required or permitted to use these standards depends on the legislative and regulatory authorities of each country.

Keywords: Financial statement, SMEs, IFRS for SMEs.

Introduction

The ongoing globalization process, coupled with the development of telecommunication and information technologies, gives an international character to the markets where contemporary enterprises operate. As the number of enterprises functioning on the market and the amount of transactions carried out are growing, the level of risk accompanying business activity is on the increase, as well.

Owing to the abundance of the companies operating on the market and the diversity of their range on offers, the choice of credible business partners both among suppliers and recipients becomes one of the key factors determining the chances for the continued existence and development of enterprises. Cooperation with reliable and solvent companies protects enterprises against the loss of financial resources involved in external assignments or their own investment projects. Therefore, it is worth considering how to evaluate the reliability of a business partner.

A financial statement is the primary source of information for external users about the economic and financial condition of an enterprise. On the basis of financial statements it is possible to present the financial position, performance and cash flow of an entity comprehensively and objectively, as well as to evaluate the efficiency of its operation and to assess prospects for future development (Buk 2006: 170).

Financial statements depending on the size entities differ in the scope and detail of reporting data. In reply to the "strong international demand from both developed and emerging economies for a rigorous and common set of accounting standards for smaller companies" (IFRS Foundation 2012). The International Accounting Standards Board (IASB) issued in 2009 the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs) (IASB Foundation 2009).

It is worth pointing here to the issue of reliability of data on the basis of which financial statements are prepared and the way these data are presented. It is not possible to correctly diagnose the economic and financial condition of an enterprise and, consequently, to draw right conclusions without reliable data. Financial statements compiled on the basis of this data should be prepared in accordance with the principle of an accurate and truthful picture.

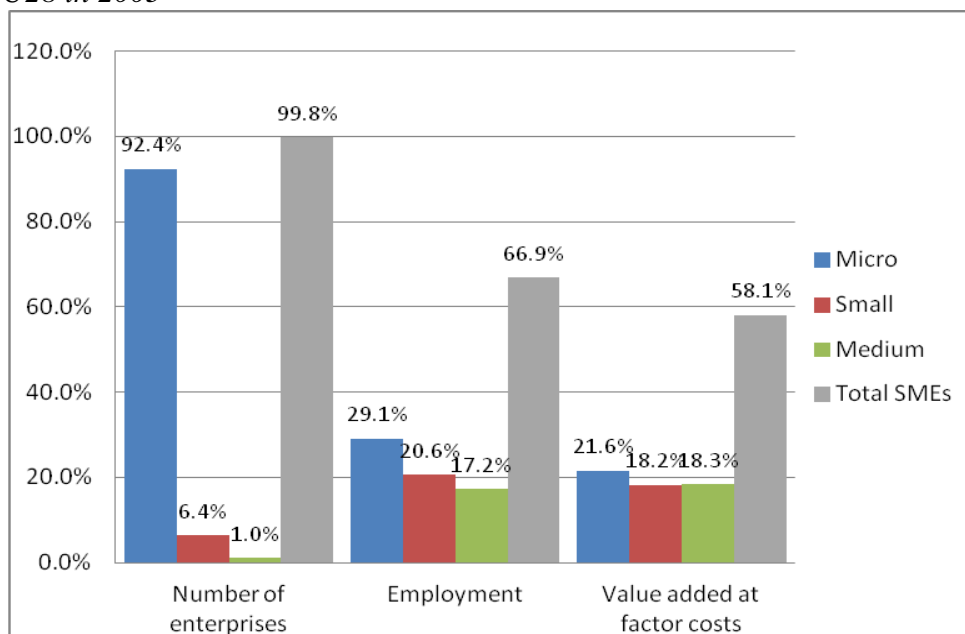
The main purpose of this article is to present the economic significance of SMEs in the UE and the importance of their financial statement as one of the determinants of business transaction securities.

In this article, we will use the following research methods - analysis of the domestic and foreign literature in the field of accounting and the method of deduction.

Economic Significance of SMEs in European Union

The economic significance and important role of SMEs show the following data presented on the chart (Figure 1). The SMEs sector share in the total number of enterprises in the EU was 99,8% in 2013. The employment in this sector was 67,4% and the value added reached 58,1%.

Figure 1. *SMEs: Number of Enterprises, Employment and Value Added in the EU28 in 2003*



Source: Compiled by the author based on Muller et al. (2014).

The share of SMEs in export is constantly increasing. In 2012 the share of SMEs to total number of firms exporting their goods outside of the EU was at the level of 78% (Table 1). As shown in Table 1, the share in the value of export of SMEs was 32%. This data shows that international trade is very important for the SMEs sector.

Table 1. *Breakdown of the Total Number and Value of EU Companies Exporting Goods Outside, by Size Category, in 2012*

	Micro	Small	Medium	SME	Total EU firms	Share of SMEs to total firms
Number of exporters outside EU	353,000	191,000	75,000	619,000	790,000	78%
Value of export outside the EU (billion €)	114	150	274	538	1690	32%

Source: Small and Medium (2014).

A Financial Statement as the Main and One of the Most Reliable Sources of Information of an Enterprise

Financial statements are the final products of inclusion and processing of data in the accounting system of an enterprise. The objective of financial statements is to provide information about the financial position, performance and cash the flows of an entity that is useful to the users in making economic decisions (IFRS for SMEs) (IASB Foundation 2009). It should give information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions.

Users of financial statements can be characterized in two ways. On the one hand, they are entities to which financial statements are addressed (recipients of financial statements). On the other hand, they are entities which take economic decisions on the basis of the information presented in financial statements. Depending on the kind of decisions taken, particular groups of users demonstrate specific information needs. Due to a wide circle of users, frequently of divergent expectations, it is difficult to prepare such a comprehensive financial statement that would satisfy the information needs of all parties concerned.¹

The range of subjects interested in the information produced by small and medium enterprises is different from the one using this kind of information in the case of big companies. First of all, the recipients of such information are not as anonymous and diffused as in the case of big companies. The subjects receiving financial information from small enterprises are usually owners, tax authorities, banks and business loan providers (Final Report 2008).

The recipients of financial reports on medium enterprises are the same as in the case of small enterprises with the difference, however, that they require even more detailed and more reliable information. It is especially important for the owners who do not participate directly in managing the company and for the creditors, since the loans (both bank and business) provided for medium enterprises are larger.

The accounting small and medium-sized enterprises are very often subordinated to the tax law, because they have no obligation to audit by an independent auditor. Tax laws are specific to each country so financial statements prepared in conformity with IFRS for SMEs are unlikely to completely agree with regulations of laws.

It is worth pointing here that the ongoing globalization process makes more and more transaction also SMEs are being carried out at a distance between counterparties from different parts of the world.

The European Commission noticed this issue and introduced separate standards for small and medium-sized entities (SMEs). The term SMEs can be

¹ R. Crandall (1969) says that there is no information system, and therefore the accounting system, would objectively be optimal for each user. As argued, he gives a variety of utility functions and information needs of different users.

defined in different ways. In this standard an SME is defined as an entity that (IFRS for SMEs) (IASC Foundation 2009: 11):

- does not have public accountability, and
- publishes general purpose financial statements for external users.

Public accountability is defined as an entity that (IFRS for SMEs) (IASC Foundation 2009):

- has debt or equity instruments traded in a public market or is in the process of issuing such instruments, or
- holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks.

The International Accounting Standards Board has prepared and established International Financial Reporting Standards for Small and Medium-sized Entities hoping that employing these standards by small and medium entities will make the data presented in these reports more comparable on an international scale. According to the IFRS for SMEs "the objective of financial statements of a small or medium-sized entity is to provide information about the financial position, performance and cash flows of the entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs" (IFRS for SMEs) (IASC Foundation 2009: 12).

The IASB wants to ensure that the financial statement was to be clear for various users and consequently it was to facilitate the processes of making investment decisions and managing the company. The financial reports prepared in accordance with International Financial Reporting Standards for small and medium enterprises were to enhance their credibility and facilitate access to the funds, including the foreign capital. Introducing the uniform international standards was expected to significantly reduce the costs of analysing the financial reports by foreign operators.

As an independent and simplified version of the full International Financial Reporting Standards, the International Financial Reporting Standards for Small and Medium-sized Entities were to be easily applied in the countries which had not decided to introduce the full version of the reporting standards. As for the countries which had introduced these standards, they were expected to facilitate the transition from the simplified to the full version in the future (Nowak 2009: 8).

Construction IFRS for SMEs based on the following elements (Sanders et al. 2013):

- the framework is built upon a foundation of pervasive accounting principles,
- historical cost is the primary measurement basis,
- disclosures are reduced, but SME users have been provided with the relevant information they need,
- familiar and traditional accounting methods are employed,
- the numbers and scope of the adjustments needed to reconcile tax return income with book income are reduced,
- the framework contains less complicated, leaner, relevant financial reporting principles for SMEs,
- the standard has been written in a clear and easily translatable language,
- financial statement matters typically encountered by SMEs are addressed.

So far over 80 jurisdictions have adopted the IFRS for SMEs or are planning it (IFSR Foundation 2012: 5).

After the implementation of standards, the tests conducted by European Commission in over a hundred entities had revealed the following defects (Sawicki 2012: 281):

- the standard covers the same elements which are included in the financial reports of big companies,
- the cost of preparation of financial statements do not balance the benefits gained by the small enterprises which are obliged to prepare external financial reports free of charge,
- the standard does not guarantee obtaining the information required by tax authorities, national statistics, management and the owners of enterprises,
- the terminology is identical with full IFRS, for example statements of financial position.

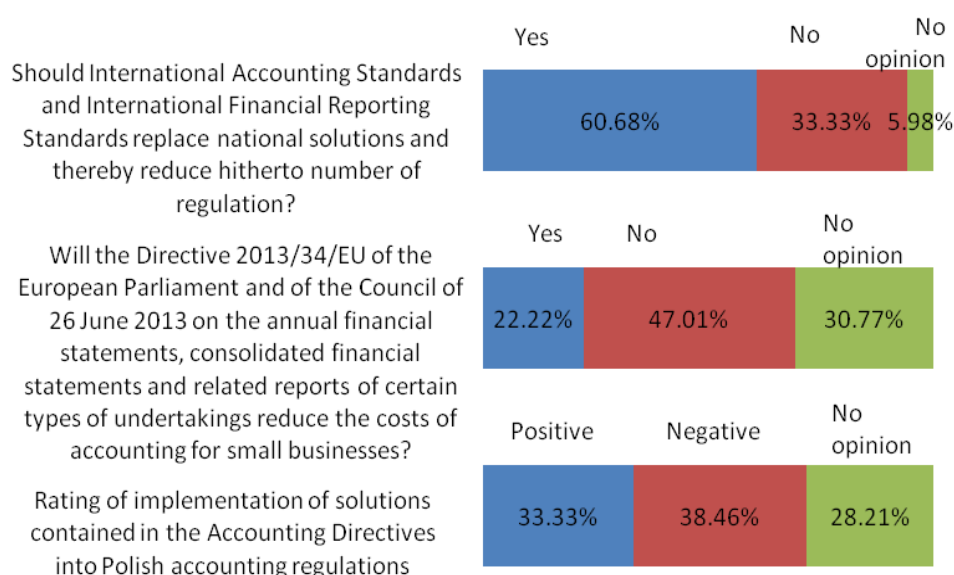
The European Union had started working on modifying the existing directives on individual and consolidated financial reports. The achievement of these efforts has been adopted by the directive 2013/34/UE of 26 June 2013. The main objective of it is to both reduce the administrative burden primarily micro and small enterprises as well as to increase reliability, brightness and comparability of financial statements. The member States of the European Union are obliged to adapt their national legislation to the requirements of Directive within two years. At the same time the final provisions of the directive will shift the deadline until January 1 2016. Because most of the enterprises have no obligation to use IFRS, the union's directive will have a greater impact for financial statements of SMEs.

National or International Accounting Standards?

Financial statements can be prepared in accordance with national or international standards. The last ones contain a more general solution, but they are more known by the users of financial statements from different countries. They are also easier to compare and interpret by foreign contractors. There appears a question, how to evaluate the process of harmonisation and standardisation of accounting standards by Polish accountants? This is the result of a research conducted by Micherda and Świetla (2014) among 117 persons for accountancy: 53 accountants, 45 auditors and 19 tax advisors.

Most of them would replace the actual solutions by International Accounting Standards and International Financial Reporting Standards, thereby reducing the number of regulations (Figure 2).

Figure 2. Research Results I



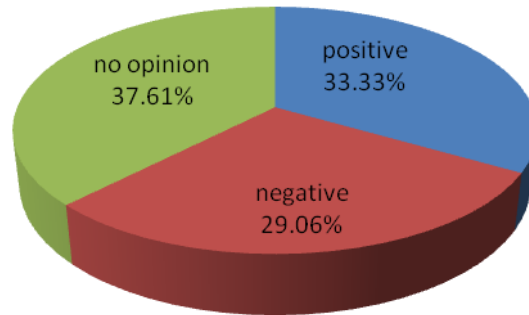
Source: Compiled by the author based on Micherda and Świetla (2014).

At the same time, however, almost half of the responses indicate that the Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings will not reduce the costs of accounting for small businesses. The opposite opinion is more than twice less popular.

The implementation of solutions contained in the Accounting Directives into Polish accounting regulations is mostly evaluated negatively, although there are only about 5% less positive opinions.

The evaluation of hitherto proposals for changes in the financial statements is not unambiguous, because there are only about 4% more positive opinions than negative, and more than 37% have no opinion at all (Figure 3).

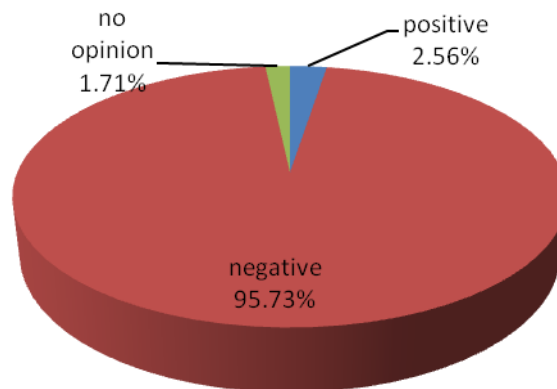
Figure 3. *Evaluation of Hitherto Proposals for Changes in the Financial Statements*



Source: Compiled by the author based on Micherda and Świetla (2014).

The evaluation of accountant vocational training is definitely negative, as nearly 96% thinks that they do not have the appropriate knowledge, and should continue learning (Figure 4).

Figure 4. *Evaluation of Accountants Vocational Training*



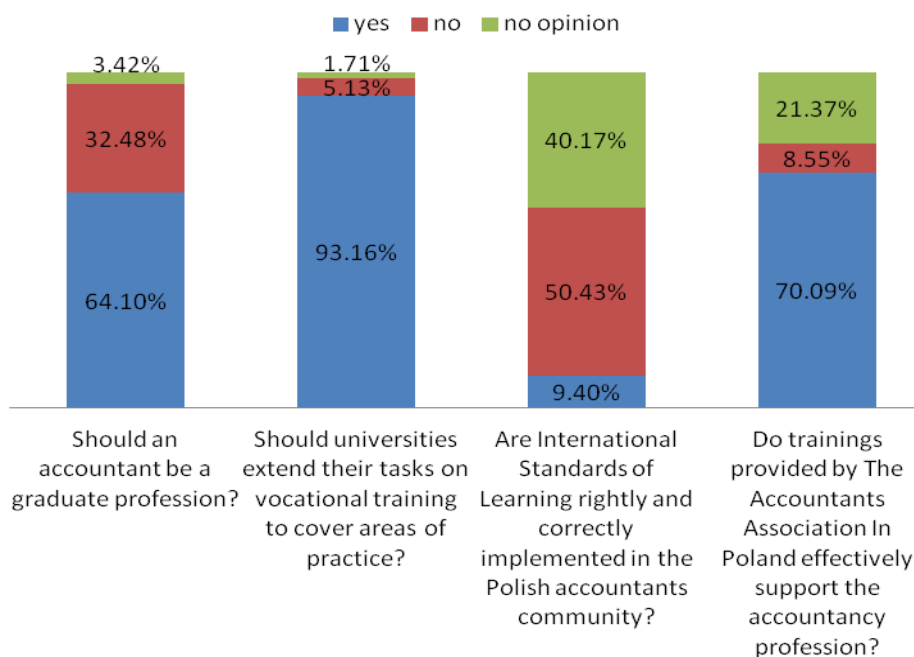
Source: Compiled by the author based on Micherda and Świetla (2014).

According to more than 64% of the respondents, accountancy should be a graduate profession. This shows that in most opinions accountants should be well prepared for their job (Figure 5). The answer to the next question follows this opinion, because over 93% thinks that universities should extend their tasks on vocational training to cover areas of practice (Figure 5).

In most opinions the International Standards of Learning are rightly and correctly implemented in the Polish accountant community but over 40%

doesn't think so (Figure 5). As it comes to evaluate the effectiveness of the trainings provided by The Accountants Association in Poland, about 70% gives a positive opinion which is over eight times more than the negative ones (Figure 5).

Figure 5. Research Results II



Source: Compiled by the author based on Micherda and Świetla (2014).

Conclusions

Due to the ongoing globalization process, the international character of the markets where contemporary enterprises operate and the transactions carried out on these markets, the risk accompanying business activity is increasing. With a view to minimizing this risk, economic entities try to check the reliability of their business partners. One of the ways for estimating the reliability and solvency of their partners is the analysis of their financial statements, because they are abundant sources of information about a company's property and its financial condition.

The financial statements can be prepared in accordance with national or international standards. Internationalization of the markets in which enterprises operate, increases the role of international accounting standards. A financial statement prepared this way reduces time and makes it easier to be interpreted by contractors. Recognising the economic significance of SMEs introduced the International Financial Reporting Standard for Small and Medium-sized Entities. Although it is undoubtedly a step in the right direction the solutions presented in these standards require a lot of amendments.

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