

Implementation of IFRS for SME in Agricultural Enterprises in the Czech Republic

Lucie Bartůňková

Abstract: *With the growing importance of small and medium-sized enterprises there is also need to harmonize their financial statements. In this connection IFRS for SME has been developed but currently, it is not part of Czech or European accounting legislation. However, there are some countries in the world that have already adopted this standard and incorporated it in their national legislation. The aim of this paper is to identify the advantages and disadvantages associated with the implementation of IFRS for small and medium-sized enterprises involved in agricultural activities and operating in the Czech Republic. This paper is based on existing experience with implementation of the standard in some countries of the world and a questionnaire survey which was carried out on a sample of agricultural enterprises in the Czech Republic. From the survey it is evident that the representatives of the accounting units interviewed are concerned predominantly about greater administrative burden, which is already now considered to be a major obstacle in the business of small and medium-sized enterprises in the Czech market, and a number of them are also concerned about high implementation costs connected with the adoption of IFRS for SME.*

Key words: IFRS for SME · Small and medium-sized enterprises · Agriculture · Advantages and disadvantages

JEL Classification: M41

1 Introduction and literature review

Recent years have witnessed the growing importance of small and medium-sized enterprises which have become a major factor of economic development, innovation and job creation. According to Longenecker, Moore, Palich & Petty (2009) these companies also play an irreplaceable role in the area of sustainable development. As Vojík (2009) pointed out, their importance lies predominantly in the fact that they promote competition in the market thus counteracting monopolistic tendencies, contribute to GDP, reduce unemployment and unlike big companies they are not characterized by production and economic inertia because they are able to respond more flexibly to changing economic conditions and current market needs. Despite their importance, however, small and medium-sized enterprises still have a low level of participation in cross-border activities, which according to the European Commission (2003) is caused mainly by existing differences in legislation between Member States, a lack of uniform accounting standards focusing on small and medium-sized companies, a lack of unified taxation policy for small and medium-sized companies, a limited supply of capital and financial resources, a lack of support for SME business in the single market and also cultural and language differences and a lack of information. A key obstacle, according to Bohušová (2007), is just differences in financial reporting across countries and significant differences in their tax systems.

Due to the existence of these barriers, efforts to harmonize financial reporting for small and medium-sized enterprises had started. The project of the International Accounting Standard Board,

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which after five-year effort released the International Financial Reporting Standard for Small and Medium-sized Enterprises (IFRS for SME) in July 2009, seemed to be the most suitable. It constitutes a basic prerequisite necessary for international comparability and transparency of financial statements of small and medium-sized enterprises at the international level. IFRS for SME is based on full IFRS, but according to KPMG (2010) it contains significant differences in recognition and valuation of assets, liabilities, expenses and revenues. The reason for these differences is mainly the need to simplify the accounting principles in IFRS for SME.

At present there is no legislation in the Czech Republic or any other state of the European Union on the use of IFRS for SME. In some other countries of the world (mainly developing countries), however, the standard has been adopted. Although there is some experience with the standard, Žárová (2011) believes that the European Commission has a negative attitude towards adoption of the standard because of a lack of sufficient experience with global implementation. The research carried out by Quagli & Paolini (2012) showed that German-speaking countries have much less understanding of the adoption of IFRS for SME in their national accounting adjustments than Anglo-Saxon countries. Currently, each particular jurisdiction has to decide whether to adopt the standard, to what extent and for which accounting entities the standard is mandatory and for which it is not.

One of the areas which still do not have any significant experience with IFRS reporting is agriculture, which is a specific sector of the national economy. Dvořáková (2012) points out that no other area of accounting is so diversely modified by national accounting adjustments as agriculture. The reason is not only different national accounting conventions but also agricultural activity itself and its peculiarities. A vast majority of business entities operating in agriculture are, according to Hinke (2006), just small and medium-sized companies, which in case of unconditional adoption of the standard will be obligated to prepare financial statements in accordance with IFRS for SME.

2 Material and methods

The main objective of this paper is to identify the advantages and disadvantages associated with the implementation of IFRS for SME in enterprises engaged in agricultural activity and operating in the Czech Republic. The first part of the paper is based on secondary research the goal of which was to evaluate existing experience with the implementation of the standard in countries which had already in the past incorporated it into their national accounting legislation.

Another part of the paper is based on a questionnaire survey, which was conducted from January 2013 to March 2013 in companies which are classified as small and medium-sized enterprises. Only companies whose subject of activity is agriculture were selected. The reason is mainly low experience with using full IFRS in this area. Currently, there are only a small number of agricultural companies which are obligated to prepare financial statements in accordance with IFRS.

In the first part of the questionnaire survey a total of 1.752 accounting units were asked the questions. Representativeness of the survey was ensured by randomly interviewed subjects, by the distribution of the questionnaire throughout the Czech Republic and by the fact that all sets of entities belonging to the category of small and medium-sized enterprises were included in the survey. The questionnaire was answered mostly by chief executives, accountants, board members and management representatives. None of the respondents were part of the consolidated group. Therefore, they were not obligated to prepare financial statements in accordance with full IFRS. The questionnaires were sent to respondents electronically via the application Google Documents. A total of 323 companies expressed their opinions so it can be said that the questionnaire produced a relatively high return rate (18.5%). This was achieved predominantly by re-contacting and re-asking respondents during the collection period. On the basis of the responses the main advantages and disadvantages of implementing IFRS for SME, which are anticipated by agricultural companies, were

discussed. At the end of the paper it was examined whether there is a correlation between the willingness to implement IFRS for SME in the national accounting system and the involvement in foreign trade of the accounting entities surveyed, which means companies supplying goods or services to other countries of the European Union. The dependence of these characters was tested by χ^2 – test of independence in a contingency table, which compares the observed simultaneous frequencies f'_{ij} with the theoretical frequencies that would be expected in the case of independence of characters.

Theoretical frequencies are denoted f'_{ij} and are subject to: $f'_{ij} = \frac{g_i \cdot h_j}{N}$, where f'_{ij} , $i = 1, 2, 3, 4$; $j = 1, 2, 3$ are so-called combined (simultaneous) frequencies and $g_i = \sum_{j=1}^n f_{ij}$, $i = 1, 2, 3, 4$ respectively $h_j = \sum_{i=1}^m f_{ij}$, $j = 1, 2, 3$ are marginal frequencies of the character of both qualitative characters and N represents the total number of enterprises surveyed.

To verify the dependence the following hypotheses were formulated:

H0: a willingness to implement IFRS for SME is not dependent on whether the company supplies goods or services to EU countries;

H1: a willingness to implement IFRS for SME is dependent on whether the company supplies goods or services to EU countries.

3 Results

As a response to the need to harmonize the financial reporting of small and medium-sized enterprises, the IASB developed and in July 2009 released IFRS for SME. This standard is designed for companies that are not subject to public interest and that prepare their financial statements for the needs of external users. The standard is based on the same principles as full IFRS but contains a lot of simplifications which are to ensure that its use will not be too complicated and will not increase the costs of preparation of financial statements of small and medium-sized enterprises too much.

At present there is a range of opinions on the adoption of IFRS for SME. According to Deaconu (2006), however, it can be assumed that there will be differences in approach to its adoption between countries which had historically developed high quality financial reporting and countries which do not have such systems. One of the proponents of IFRS for SME is the Republic of South Africa, which was the first country to adopt the standard. It already adopted it in 2008 in the form of the then proposal. The reason, according to Sacho & Oberholster (2008), was their not very well developed national system of financial reporting. The fact whether there is a link between tax and accounting reporting also has some influence on the willingness to adopt the standard. Although accounting rules are separated from tax rules, the authors Fekete, Cuzdriorean-Vladu, Albu & Albu (2012) point out that there is a close link between them in practice. It can thus be assumed that the willingness to adopt the standard will increase if there is a link between IFRS for SME and the income tax base.

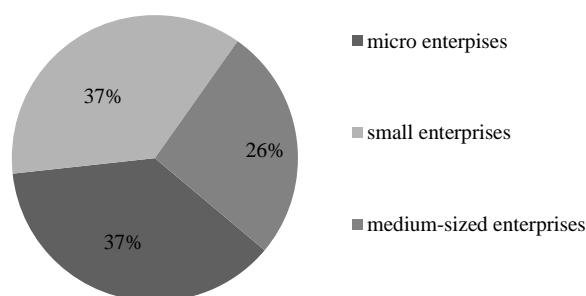
Analysis of the advantages or disadvantages connected with the implementation of the standard in small and medium-sized enterprises had already been dealt with by the European Commission. In November 2009 it published a discussion paper which contained 12 questions relating to the issues of IFRS for SME. On the basis of the replies received the European Commission (2010) identified the main advantages and disadvantages connected with the implementation of the standard. Supporters of the standard predominantly evaluated the possibility of preparing internationally comparable statements positively. They hope to lower expenditure on the acquisition of foreign capital and be-

lieve that establishing uniform rules for financial reporting will also increase mobility of accounting and auditing work. On the other hand, the adoption of IFRS for SME is, according to respondents, associated with several disadvantages. These may include, for example, the creation of implementation costs which are costs connected with implementing a new management system, changing accounting software, training staff, etc. Another concern is about potential increase in administrative costs.

In Turkey, analysis of the advantages and disadvantages connected with the implementation of IFRS for SME was discussed by Arsoy & Sipahi (2009). In their study they positively evaluated the possibility of preparing financial statements that are internationally comparable across different economic sectors. Further, they assume that the introduction of IFRS for SME will help penetrate foreign markets, form new business combinations and establish agreements on cooperation with foreign entities. On the other hand, they fear that the costs connected with implementation will outweigh the expected benefits. The authors are also concerned about the costs associated with training accountants for a new system of IFRS for SME. Also in Sweden the authors Aamir & Farooq (2010) in their research came to the conclusion that companies are not willing to switch to another system of financial accounting for fear of increased implementation costs.

A total of 323 enterprises were involved in the research held in the Czech Republic into companies engaged in agricultural activities. Distribution of companies by size is shown in Graph 1. Distribution of companies into size groups was based on the European Commission Recommendation No. 2003/361/EC, which in the year 2003 established a uniform definition of small and medium-sized enterprises in the European Union. The main criterion for classifying companies was the number of employees. Complementary criteria were annual turnover and the balance sheet total.

Figure 1 Distribution of respondents by company size



Source: Author's own elaboration based on survey of the questionnaire

On the basis of the responses received the main advantages and disadvantages connected with the implementation of IFRS for SME in the Czech for small and medium-sized enterprises were identified. The entire research was greatly complicated by the fact that there is currently relatively little public awareness of IFRS and IFRS for SME. When asked if they had come across the term IFRS for SME in the past, 73 percent of respondents answered "no". For this reason, the questionnaire was supplemented with a document containing a brief description of the standard. The results revealed that companies believe that the implementation of the standard will help increase credibility with business partners. On the other hand, they do not believe that its implementation will attract foreign investors into the companies and or improve access to external sources of financing. Respondents are not convinced that their companies will even be better perceived by the gene-

ral public. They positively evaluate the preparation of internationally comparable financial statements for the purpose of obtaining subsidies and grants both from the state budget and particularly from foreign funds.

Negative attitude towards IFRS for SME can be attributed both to a lack of knowledge about IFRS for SME and the pessimistic perception of any changes by the representatives of the respective companies. Respondents are concerned predominantly about increased administrative burden. A number of them complained in their replies about excessive bureaucracy in agriculture, especially in organic agriculture. It is the administrative burden which small and medium-sized enterprises operating in the Czech Republic see as the biggest obstacle to their activity. The respondents also voiced their fears that the introduction of IFRS for SME into their accounting system will be accompanied by high implementation costs.

What small and medium-sized enterprises regard as another disadvantage is the fact that currently there is no link between the income tax base and financial reporting in accordance with IFRS for SME. This was also confirmed by the survey carried out by Müllerová, Paseková & Kubíčková (2010), which showed that the main problem with the application of IFRS for SME for Czech companies is the fact that the income tax base is determined on the basis of profit which is calculated according to the Czech accounting legislation. Summary results of the questionnaire survey are shown in Table 1.

Table 1 Summary results of the questionnaire survey

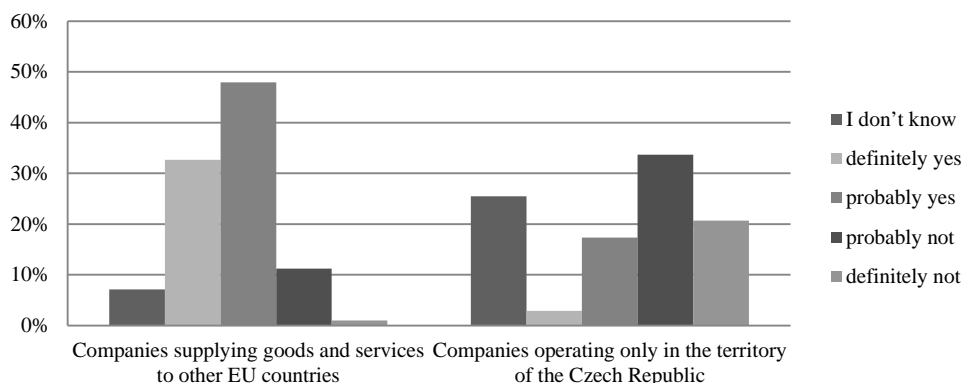
What would IFRS for SME mean for your company?	Yes	No	I don't know
An increase in credibility with business partners	40 %	26 %	34 %
Attraction foreign investors	21 %	41 %	28 %
Better perception of your company by the general public	25 %	50 %	25 %
Opportunity to obtain subsidies	38 %	25 %	37 %
Greater administrative burden	64 %	5 %	31 %
High implementation costs	48 %	9 %	43 %
Problem with profit in accordance with IFRS for SME and taxation	57 %	4 %	39 %

Source: Author's own elaboration based on survey of the questionnaire

The final part of the survey was aimed at whether the willingness to incorporate IFRS for SME into enterprise accounting systems depends on whether companies supply goods or services to other EU countries. The relationship between the two variables was tested by a contingency table and statistical analysis was performed using Unistat. After evaluation a strong correlation between the tested features was proved, the null hypothesis was rejected and it was confirmed that the willingness to implement IFRS for SME depends on whether the company supplies goods or services to other EU countries. This statement is also confirmed by a graphical representation of the responses received.

Possible adoption of IFRS for SME by agricultural enterprises will bring a lot of changes in financial reporting. An accounting unit will have to comply with Section 34 IFRS for SME Specialized Activities, which also regulates agriculture. In contrast to the Czech accounting laws, the most important change will be the need to revalue agricultural produce and biological assets at fair value. This fair value will subsequently be reduced by the costs associated with sale. This procedure can greatly complicate the valuation work of the company. Only if the company is not able to determine fair value without excessive costs and excessive effort, IFRS for SME allows valuation of biological assets at acquisition costs, which are reduced by accumulated depreciation and accumulated impairment losses.

Figure 2 Opinions of respondents (according to their involvement in foreign trade within the EU) as to their willingness to implement IFRS for SME in the future



Source: Author's own elaboration based on survey of the questionnaire

4 Conclusions

The aim of this paper was to find out the extent of quality management certificates and Costs of Quality system among companies in the Czech Republic and to ascertain if using of these quality management tools is associated with better financial performance of companies. Here are presented the main conclusions.

With the growing importance of small and medium-sized companies there is a need to harmonize their financial statements at the international level. In this context, great credit should be given to the IASB, which issued IFRS for SME in 2009. Currently, the standard is not part of Czech or European accounting legislation. Therefore, each country has to make its decision on whether or not to adopt the standard. Nowadays there are different opinions about its application. Although it has its proponents, the attitude of agricultural companies in the Czech Republic towards its possible implementation is rather negative. The main reason is predominantly their fear of increased administrative demands and also high implementation costs.

It is evident that although there is now a tool for global harmonization of financial reporting by small and medium-sized companies, the purpose will not be accomplished until it is adopted by most countries of the world. If IFRS for SME is to be adopted in the Czech Republic, it is necessary to take steps to reduce the administrative burden and to explore the possibility that the income tax base will be based on profit calculated after the application of IFRS for SME. For implementation of IFRS for SME in the Czech Republic the most important, however, will be the opinion of the European Commission and the fact whether the Directive obligating member states to incorporate it into their national accounting legislation will be adopted.

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