IFRS for SMEs and NGOs – Burden or Advantage

Ján Vlčko

University of Economics in Bratislava, Faculty of Economic Informatics,
Dolnozemská cesta 1, Bratislava 5, 852 35
Slovak Republic
jan.vlcko@euba.sk

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Abstract. IFRS for SMEs is issued as standard for a while now. In Slovakia it is still not allowed to use officially for the legal official financial statements. IFRS for NGOs is even not proposed yet. Some SMEs and NGOs need to disclose their financial statements according to accepted international accounting standards or according to foreign accounting standards. Companies with foreign ownership represent less than 10% of all companies but provide more than 40% of net turnover. Legislative makers in Slovakia does not reflect to the market demand and trends by updating legislative what forces some SMEs to perform dual accounting, legal based on SK GAAP and unofficial based on IFRS. There are some concerns of IFRS for SMEs adoption in Slovakia which needs to be overcame and risks mitigated. This paper provides brief overview of arguments and reasonings to get IFRS for SMEs implemented in Slovakia. On examples of real NGOs, it is shown how dual accounting rises expenses and administrative burden. US GAAP also cover NGOs, while IFRS do not. Policy of both to converge each other provides hope that even IFRS for NGOs will be once proposed.

Keywords: IFRS, SME, NGO, accounting.

JEL classification: *E44, J30*

1. Introduction

In the very beginning it needs to be mentioned that officially there is nothing like IFRS for non-for-profit organisations (further as NGOs). IFRS are in place for a while now and they are still spreading to new theories, industries and even to a new type of companies. Disclosure of financial statements according to IFRS is, in general, required for listed companies worldwide. IFRS have been created for profit-driven companies and their attitude is to serve them as a guidance to disclose their financial positions and information understandable and comparable to wide range of international users. Therefore, with no doubt, implementation, and usage of IFRS among listed companies has its purpose, results, and advantages. Meanwhile the spread of IFRS showed that even some companies which are not listed or publicly traded may be interested to voluntarily disclose their financial information according to international standards. Reasoning for such conduct may be for example: showing themselves to an international business partner, applying for an international financing scheme or grant or preparation to merge with another company in the industry, etc. Therefore, new standard IFRS for SMEs have been released (1). This standard, unlike other IFRS standards, is only one standard covering range of other IFRS standards. As its name shows, its purpose is to serve SMEs and it provides them simplified IFRS approach. IFRS for SMEs cannot be used for public interest companies – listed on public market or OTC market. (1) Unfortunately, IFRS for SMEs is not yet recognised by European Commission as accounting standard allowed to be used officially within EU boundaries. Also, not all issued IFRS standards are recognised within EU. Only those are allowed which are in official EU Commission regulation 1126/2008 (2).

Unlike IFRS, US GAAP is created not only for business companies but also for not-for-profit organisations. This is due to differences in American and European approach of financing NGOs and therefore need to disclose and report financial figures of NGOs to public, donors, and government (3). Because of some NGOs activities are financed from public sources or EU funds there is space for application of accounting standards for NGOs, that would provide similar advantages and benefits as IFRS. NGOs are organisations that are not meant to generate profit to their stakeholders. Their purpose is to serve for public benefit (4). Therefore, the question arises whether application of international accounting standards would be beneficial for the SMEs and for the NGOs, or it would be a burden for them. Current literature focus more on accountability (4) (5) than on implementation of unified accounting standards. This contribution is aimed to find the answer by analysing available data from Slovakia. It has to be mentioned that Slovakian legislation does not allow SMEs and NGOs officially to apply IFRS or any other accounting standards than Slovakian GAAP provided as law (6). Slovakian accounting act allows IFRS to be applied only for public interest companies and companies that meet volume-based criteria (6). Therefore, even an SME or an NGO is part of consolidation it must issue financial statements according to Slovakian GAAP and for the consolidation purpose according to IFRS (7). This can be achieved either by performing side to side accountancy, one based on Slovakian GAAP and second by IFRS. Or by correcting SK GAAP statements to IFRS statements. None of this is without an effort and the question is why there shall not be possibility to apply only IFRS as widely acceptable and widely spread standards than national GAAPs.

1.1 Dual accountancy performed by SMEs (and NGOs)

SMEs which are part of the consolidation in many cases use holding’s ERP system for their operation. This allows them not only to comply with the holding’s policies, practices, and processes, but it also enables company to perform accountancy based on IFRS. For the purpose of creating consolidated financial statements, the booked figures in each entity of the same manner are taken and counted (7). Therefore, it is necessary to book all records in the same manner as the performer of consolidation. As the IFRS is transaction based accounting and Slovakian GAAP is generic accounting, there is obvious difference between these two approaches. In case the SME is small with only little transactions it is possible and easier to just adjust SK GAAP financial statements to create statements for consolidation purpose. However, in many cases the final financial statements are not enough information source for users of financial statements as yearly figures are given late and may not be in time of making decisions. Therefore, it is often required to provide figures of SME also from within a financial year either by interim financial statements or by simple enabling mother company to use figures from SMEs ERP system. That financial information shall be of the same manner as the mother company, so they can be used within the holding for users of information to make decisions or just to check performance of the SME. The same applies to NGOs of a foreign origin who are part of the consolidation.

Dual accountancy, nevertheless, it is required due to nature of the origin of the SME, its holders, its reporting requirements, and needs is performed at the edge of the law. According to Slovakian accounting act (6) it is not allowed to account outside accounting books. Accounting books are mentioned in in the act. The question arises whether if the SME performs accountancy in its accounting books according to the accounting act and also elsewhere according to IFRS it is considered as booking outside the accounting books or not as IFRS books are not mentioned in the act at all.

Result of the SK GAAP financial statement is used as a base for profit tax calculation. For big companies which are required or allowed by accounting act to perform only IFRS accounting, the result gained from IFRS statement are taken as a base for profit tax calculations. Therefore, the question is why SMEs who perform IFRS accountancy cannot use IFRS statements results also for profit tax calculations.

1.2 Concerns

As the taxation and accounting is strongly bounded in Slovakia, and also elsewhere, the main concern is whether IFRS is suitable for determination of tax base. It is worth to mention that as IFRS is meant to be internationally consistent, there is also a movement to make profit taxation determination and reporting internationally consistent. One of such deeds is CCCTB (8), the approach of European commission to unify taxation within EU, which is still in the phase of proposal and development. Based on study, financial accounting and tax accounting shall be separated, as IFRS is based on principles rather than on strong rules (9). If the financial accounting and taxation will be bounded, there is still concern of tax motivated accounting (10). Purpose of accountancy shall not be tax calculation, but to show true financial status of the company to users who have not access to detailed information of the company, namely from outside of the company. Tax administration is one of the users of financial statements, however in 21st century of digitalization and AI, tax administration shall be capable to perform investigations, inspections, tax determinations using information from other sources then financial statements only, for example from digital exchange of business information (11). Financial statements for tax fraud determinations are not suitable as they are disclosed after the end of financial year, which is too late for this purpose. Supervisory authority for accounting in Slovakia is Tax authority which is also supervisory authority for taxation. This speaks out for itself why in Slovakia taxation and accounting is so strongly bounded.

Another concern is that SK GAAP rules strongly dictate what must be booked on which account, list of account is part of the SK GAAP. Therefore, each company shall book each transaction in the same way. As mentioned before, SK GAAP is generic accounting which leaves gap for management accounting to step in to provide useful information regarding to transactions, processes, and business activities in the form useful for managers. Transaction based accounting is capable to provide more useful information in such cases than generic accounting. However, leaving generic accounting and switching to transaction-based accounting allow each entity to book same transactions slightly differently. Question is whether it is bad or good. If the companies tend to perform accountancy correctly, they shall have freedom to book transactions to provide as much useful information as possible, while companies who tend to pretend their financial position, do so regardless to which accounting rules are in place.

When concerning concerns there is also lack of personnel. Lack of personnel is an issue in almost any industry and is due to natural demography (12). In Slovakia, accountancy is free trade, what means it can be performed by any person, no matter of its education or knowledge. Because of strong legal requirement of performing SK GAAP only, there is education of accountancy in place mostly for SK GAAP. It is not a standard to provide IFRS education in common economic high schools and accounting courses, because there are not so much IFRS allowed companies. Therefore, to apply IFRS in practice it is required also to change mindset from generic booking to transaction booking. As it is not deeply educated topic, except in university, there is concern that accountancy based on IFRS in SMEs may not be performed correctly. Such risks may be mitigated by Audit. Audit is required only when company meet volume criteria what most of the SMEs do not meet. Voluntary audit is also possible. This risk may be also mitigated when company is part of consolidation and use holding's ERP which is set by mother company. In such cases most of the operational transactions are booked in the same manner in whole holding and therefore mother company may provide assistance and assurance that accounting is performed correctly. Mother company is subject to audit and consolidated statements are also subject to audit, mother company tend their subsidies to perform accountancy well. Lack of accountants may be partially solved by automatization of accounting (13).

IFRS as principles do not provide any forms of statements. They just mention what kind of information must be disclosed (14). Therefore, it is up to a company to display information in form useful for users. Every company shows their financial statements in different visualizations. Despite of it looks nice to read, it is not suitable for machine processing, what may be one of the reasons why legislative creators tend to be resistant to allow IFRS for SMEs. Anyway, such obstacle may be easily overcome by providing standardization of forms of financial statements. Standardization of statements does not comply with the IFRS idea that every company knows itself the best, so is capable to display its figures and information in financial statements in the best way possible. Standardization of forms of financial statements may be a step back. One shall mind that once the tax reporting and accounting get separated, there is no more need for standardized forms, especially when AI is capable to read and withdraw information from the non-standardized statements in similar way than a human would do. Such approach requires more intense adoption of AI, but it can provide more useful information in financial statements. In the other hand, when holding's ERP is in use in an SME, then the SME may use the same form of statements than its mother company. Therefore, some form of standardization is in place always what makes and order in displaying disclosed information.

There are, for sure, much more concerns to consider. These are just those the most obvious. There is also convenience of supervisory authority which has much less effort with standardized information than unstandardized, no matter how this affects supervised companies financially and bureaucratically, even standardized information may not provide that much useful information than unstandardized would do.

2. To whom it may concern

As already mentioned, SMEs which are part of consolidation are affected the most as they are forced to pretend extra expenses for dual accountancy. But how many of them are really affected. "SME represent more than 95% of all companies worldwide" (15). Yearly financial statements of Slovakian companies are public documents and are easily accessible in the register on internet for free. Despite of that there is lack of information whether a company is part of consolidation or not in standardised forms. This information shall be displayed in notes to the statements which are, for their nature, not standardized. Because there are more than 200k financial statements submitted a year in Slovakia alone, it requires an AI machine to read and evaluate all notes of financial statements. As we do not have such AI capability, we can just show percentage of companies with foreign ownership. Not every company with foreign ownership is part of consolidation. Foreign owners may be interested in financial statements compiled based on IFRS or IFRS for SMEs rather than on SK GAAP.

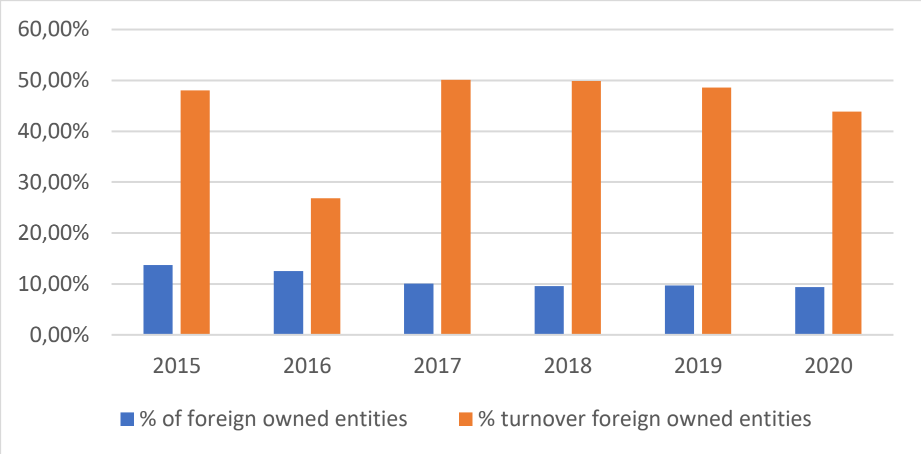

Figure 1. Percentage of foreign owned companies to total companies and percentage of foreign owned companies net turnover to total net turnover. Only data from non-defaulted and non-terminated companies were considered.

As shown in the Figure 1, the turnover of foreign owned companies to total net turnover is significant. This figure does not show the percentage of companies or their turnover which ones already disclose their financial statements according to IFRS. Only financial institutions must use IFRS and companies who meet at least 2 of these 3 criteria: Net turnover exceed 170 mil €, net assets exceed 170 mil € or average number of employees exceed 2000. These volume criteria are so significant that even few such companies change the figures in the graph. Number of foreign owned companies in 2020 was more than 19 000, what results that majority of the foreign owned companies are not those disclosing their financial statements according to IFRS.

Disclosing financial statements according to IFRS and performing accountancy according to IFRS may not be interested only for companies with foreign ownership, but also for companies granted EU Funds grants or any other foreign origin grants or subsidy. EU funds are project based fundings to provide finances to range of projects to help fulfil long-term EU policies. They are budgeted for periods of years and therefore could be used for long term projects. Money must be spent on approved project according to criteria. Spendings are subject to double check. Financing is usually via tranches and before any tranche, previous one must be reported and spendings checked by supervisory institutions, in Slovakia MIRRI. Part of the reporting are financial figures and disclosures. It is not required to report financial figures according to IFRS but doing so may provide greater assurance not only to MIRRI, but also to EU institutions. As this approach is hypothetical, we are not going to spend more space hypothesizing here.

Special case which is out of the focus of both scholars and governments are NGOs. One of the reasons is that NGOs does not generate taxable profit and therefore in many cases are not obliged to submit tax return. In Slovakia only those NGOs which submit tax return must also submit financial statements, which appear in public registry of financial statements. Nevertheless, even NGOs must perform accountancy even their statements are not submitted. NGOs which are financed, granted, or subsidized from abroad must report to their foreign donors or sponsors according to foreign GAAP; to the USA according to US GAAP or according to (pseudo) IFRS. Because they do not submit financial statements nor tax return, it is almost impossible to determine their turnover or impact on GDP. Placing reporting burdens to NGOs shall not be the way as their purpose is to provide services to public benefit and most of them are small gatherings of ordinary citizens, no matter of their legal form, who pretend some common interest. The idea of this text is that if any NGO has need to perform accountancy according to international standards, it shall be allowed to do so. Current accounting act, as already mentioned, requires to perform accountancy according to SK GAAP. An NGO then must perform dual accountancy. NGOs with might be interested in performing accountancy according to international standards, if they already do not do so, are for example: international charities, churches, sport clubs, international schools, and their branches, etc.

The question arise why micro NGOs must perform accountancy at all. For example, in Slovakia, self-employees are allowed to perform only tax records consisting only cash-flow – no accountancy, but NGOs must perform simple accountancy even they do not have any users of their financial statements. Further research is needed to determine when NGO shall be released form the burden of performing accountancy at all and when it is necessary to do so at least for government reporting purposes. And if NGO must perform accountancy whether it shall be allowed to do it according to international standards only.

3. Methodology

To describe the extra effort which must be performed by an organisation, we analyse data of 2 real NGOs which operate in Slovakia. Both are of the foreign origin, and both are obliged to regularly report their financial figures to their parent organisation due to be the part of the consolidation unit. Because the data are protected by the law as secret, names and detection information are not disclosed in this paper. Rather labels as Organisation A and organisation B are used.

Brief information of the size of both organisations is mentioned in Table 1. Both are budget organisations therefore they do not generate any profit.

Table 1. Brief overview of both analyzed organization showing their turnover in 2021.

	Organisation A	Organisation B
Yearly turnover:	699 175 €	768 181 €
Out of which:		
Money from parent or sister organisations:	555 725 €	692 291 €
Money from government grants and subsidies:	107 550 €	2 240 €
Donations and gifts:	22 250 €	72 650 €
Revenue from rent	13 650 €	
Average no. of employees:	18	5

Average no. of volunteers:	20	22

Organisation A reports their figures according to pseudo-IFRS standards based on the IFRS. Organisation A voluntarily let their official Slovakian financial statements to be audited. Organisation B reports their figures according to US GAAP.

3.1 Expense for dual accountancy

As both organisations must perform accounting according to Slovakian GAAP, they need to employ 1 full time employee (further as FTE) for accounting. Slovakian Accounting act allows to perform accounting by a supplier, but these organisations prefer to hire own FTE to do the task, because in case of supplying accounting services there still must be an administrative employee who would prepare the documents for an accounting supplier. This can be joined in 1 FTE who collects, prepare, book, and account all documents. As both organisations must also report to their parent organisations, according to parent GAAP due to consolidation and due to management accounting, they use parent organisation's ERP software for the task. ERP is given by a parent organisation for free. Even if it would not be free, usually NGOs has much lass prices for such software than business companies. Accounting in foreign GAAP is performed in English, only digitally. Due to need to use English as standard, it needs to be reflected in higher salary. Comparison of yearly expenses can be seen in Table 2. SK GAAP is performed in paper, due to legal obstacles of digitalisation, such as need of 2 signatures. Foreign GAAP is performed digitally only, what means each paper document is scanned and attached into the software record.

Table 2 Yearly expense for performance of accounting

	1 FTE foreign GAAP accountant	1 FTE SK GAAP accountant	SK GAAP software	Office supplies due to SK GAAP	Penalties from SK Tax administration	**TOTAL**
Organisation A	24 000 €	18 000 €	600 €	850 €	60 €	**43 510 €**
Organisation B	24 000 €	16 500 €	600 €	1 250 €	30 €	**42 380 €**

As seen from the Table *2*, the expense for foreign GAAP performance is 3.43% of turnover in organisation A and 3.12% in organisation B. Performance of SK GAAP is 2.79% in organisation A and 2.39% in organisation B. This however does not contain indirect expenses and effort such as HR, legal requirements, administrative requirements etc.

4. Conclusion

IFRS was not created for SMEs and NGOs at first place. Reporting needs of SMEs and NGOs to report and disclose their statements to the range of users exceeding borders of their operational address arise general need to unify accounting standards even of SMEs and NGOs. Statements of SMEs and NGOs must be readable and understandable to the variety of international users of financial statements and financial information so they may stand strongly among the international competition or apply for fundings from abroad financial sources. To meet this goal, they have no other option in Slovakia, but perform dual accountancy: legal official one and (illegal) one based on IFRS that meets their reporting needs. Because IFRS is much broader than national GAAP and requires more expertise approach companies who choose to use them are doing so highly exceeding legal requirements. As briefly shown in this paper, accounting act in Slovakia is highly outdated and needs to be updated to comply with international accounting and reporting trends and needs. Solution is not only to update accounting act but also updating all other acts that affect accountancy. And educate accountants, businesspeople, and government institutions employees to switch from generic accountancy to transaction-based accountancy mindset. To meet this goal, separation of financial and tax accounting must come first. Further research and development are needed. As IFRS for SMEs is getting implemented worldwide, it is an advantage to watch what impact, positive and negative, it has in countries where it has been implemented recently.

Despite of issuing simplified IFRS for SMEs standard it is still not recognized by European commission. Regarding to NGOs, there is even not a proposal for such standard. Comparing it to US GAAP where standards are applicable also for NGOs, European NGOs may hope that policy of convergence between US GAAP and IFRS may bear fruit also in this area.

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