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Original Paper

Financial Reporting for Small and Medium-Sized Enterprises (SMES) In Nigeria: A Review of Literature

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Abstract

This paper reviews literature of financial reporting by small and Medium-Sized Enterprises (SMEs) with particular reference to Nigeria. The study justifies the use of International Financial Reporting Standards (IFRS) by Nigerian enterprises. Thereafter, the paper recognises the economic importance of SMEs both globally and in Nigeria. Justification for differential reporting between listed entities and unlisted SMEs was articulated. The paper notes the advantages and challenges related to adopting IFRS for SMEs globally and in Nigeria. It is recommended that further research be undertaken to access empirically the impact and consequences of adopting IFRS for SMEs by unlisted enterprises in Nigeria.

Keywords

financial reporting, small and medium-sized enterprises, IFRS for SMEs, Nigeria

1. Introduction

The adoption of a single set of International Financial Reporting Standards (IFRS) globally, enhances comparability of financial reports within and between countries (Madawaki, 2012). IFRSs make information more comparable, thereby enhancing evaluation and analysis by users of financial statements, cutting the costs of doing business across borders by reducing the need for supplementary information and thus creating an enabling environment for investors to be able to effectively compare investment opportunities across the global market. With financial reports based on IFRS, users become more confident of the information they are provided, and presumably the reduced uncertainty promotes an efficient allocation of resources and reduces capital costs. For example, a key policy strategy in repositioning the Nigerian economy is the attraction of Foreign Direct Investments (FDIs) into the country to provide investible funds (NASB, 2010). However, FDIs in Nigeria have declined: from US$6.9 billion in 2007 to about US$4.602 billion in 2008 and US$3.94 billion as at September 30, 2009. The decline in FDI is primarily due to the perceptions of risk in Nigeria. The perception of Nigeria as a risky country for the flow of FDIs is, in part, attributable to the limited financial reporting and disclosures made by reporting entities in Nigeria. This was so (prior to compulsory IFRS adoption in 2012) because some of these entities did not provide investors with sufficient economic information that would enable them understand the risk profiles of such entities to permit informed judgments and decisions. International and national investors are better placed to make rational economic decisions when financial information is comparable between countries competing for foreign investments. Given the increasing globalization of capital markets, and the factors mentioned above, Nigeria compulsorily adopted the IFRS for its listed companies, (about 200 in total, NASB, 2010) from 1st January, 2012. The unlisted small and medium-sized enterprises represent Nigeria's economic backbone: they are estimated to be 37.06 million in number, employ at least 59.74 million people representing 84.02% of the total labour force and contribute 48.7 per cent or ₦38.78 trillion to Nigeria's Gross Domestic Product (GDP) and 7.07 per cent of export earnings (SMEDAN, 2013; Dikko Radda, 2018) (Note 1). In addition, SMEs contribute over 90% of the private sector production and the prime sources of jobs and play a crucial role in income generation especially for the poor (Modugu & Eragbhe, 2013).

Globally, SMEs represent well over 95% of all companies in both the developed and developing countries (IFRS, 2009). For example, (i) SMEs are a major driver of the Singapore economy, accounting for 99 per cent of all enterprises in Singapore, employing seven out of every 10 workers, and contributing over 50 per cent of national gross domestic product (Lee, 2012). (ii) SMEs accounted for 99.7% of actively trading businesses in Australia in June, 2009 and accounted for 70.5% of total industry employment in 2009-2010 (DIISR, 2011). (iii) SMEs in China accounted for 60% of GDP in 2009 and created 80% of job opportunities in 2009 (Zhu, Wittman, & Peng, 2012). Almost 99% of businesses in Japan are SMEs, representing the majority of the employed population and accounting for a significant proportion of the economic output (EIU, 2010). Similarly, in Europe, SMEs accounted for a 67% share of total employment in 2010; SMEs created 85% of net new jobs in the EU (EIM Business and Policy Research, 2011). US SMEs in the manufacturing and service sectors are known to have entered into "direct exports". By contrast, large multinational firms trade mostly through foreign affiliates; 73% of foreign sales were committed by exporting SMEs through direct sales leading to the creation of nearly 2 million jobs (USTR, 2010). These indicators point to fact that the SME sector is the backbone of any developed or developing economy around the world. This sector makes an enormous contribution to employment creation and economic output (Chen, 2006; OECD, 2005; Reddy, 2007) and has an enormous economic significance (Tiron-Tudor & Mutiu, 2008). It should follow naturally that accounting information presented by these focal entities is equally important. Taking these into account, we review literature related to financial reporting by SMEs globally and Nigeria in particular.

The paper is structured thus: the next section provides justification for a differential reporting framework for SMEs, followed by a review of IFRS for SMEs highlighting the major differences with the Full IFRS. Section 4 reviews the benefits of and obstacles to the adoption of IFRS for SMEs; sections 5 and 6 address financial reporting by Nigerian SMEs and the challenges confronting Nigerian SMEs regarding adoption of IFRS for SMEs respectively. Section 7 concludes the paper.

2. Different Reporting Framework for SMEs

The objectives of general purpose financial statements are the same for both listed and unlisted entities. However, it is acknowledged that the types and needs of users of SMEs' financial statements are different from users of financial statements of listed and/or larger entities (International Accounting Standards Board (IASB), 2004, p. 15). Users of SMEs' financial statements may have less interest in certain aspects of financial statements prepared by listed or other entities with public accountability. Consequently in 2007, the IASB proposed an Exposure Draft (ED); *IFRS for SMEs* affirming the fact that the objective of financial statements 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". For SMEs, the IASB took the position that financial reporting should be assessed on the basis of cost and benefit trade-off regarding the information needs of the users of an entity's financial statements (IASB, 2004, p. 15). Accordingly, the IASB proposed that financial reporting standards for SMEs should provide high-quality understandable and enforceable standards suitable for SMEs and should meet the needs of the main users, who are, in order of relevance; tax authorities, banks, investors not involved in the day-to-day management of the business, customers and suppliers and employees (Bertoni & De Rosa, 2010).

In plain language, it should be clear that a strict compliance with the full IFRS requirements by SMEs would be expensive, onerous and financially burdensome and may even be irrelevant. For example, users of accounts of a small company do not require complexities such as deferred tax, finance leases, financial instruments, pensions, share based payments, *etc*. They need to see accounts conveying absolute information about future cash flows rather than relative measures of performance. They do not need to see meaningless numbers in the financial position statement informing them about the existence of hard to value assets or liabilities. They can read the notes to identify their existence and obtain information about their implications for future cash flows. For these reasons, many countries (including South Africa, Canada, United States, United Kingdom, Australia, New Zealand, Nigeria, among others) have adopted full IFRS for publicly accountable entities, but are reluctant to adopt this set of complex, onerous and costly standards for non-publicly accountable entities particularly SMEs (Perera & Chand, 2015; Dang-Duc, 2011; Fearnley & Hines, 2007; Tyrrall, Woodward, & Rakhimbekova, 2007). It is noteworthy that South Africa embraced differential reporting (public accountability entities versus limited interest entities), adopting the IFRS for SMEs in its draft form as a transitional standard for "limited interest companies without public accountability" in 2007. Thus, South Africa is the first country in the world to to have used the *IFRS for SMEs* (Stainbank, 2010). South Africa's pioneer adoption of the *IFRS for SMEs* was driven by: (1) the urgent need for auditors to express an opinion on financial statements prepared in accordance with an accepted framework of the auditing profession in South Africa, and (2) the need to provide a beneficial framework for SMEs to prepare financial statements (Stainbank, 2010).

3. IFRS for SMEs

In 2009, the IASB issued the IFRSs *for SMEs*, a self-contained document with no cross-references to the *Full IFRS*, for use by entities that do not have public accountability. An entity has public accountability under the IASB's definition, if it files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; or holds assets in a fiduciary capacity for a broad group of outsiders. IASB has no quantitative criteria defining an SME; it is not feasible to develop quantified size tests that would be applicable and long-lasting in all the over 100 countries that use IFRS standards. Furthermore, in applying the IFRS globally, it is hardly possible to define constraints; an entity that is regarded as small in one jurisdiction may be regarded as very large in another, therefore, only qualitative criteria are crucial (Beiersdorf, Eierle, & Haller. 2009).

The IASB's accounting framework for non-publicly accountable entities and others that are not of the size nor have the resources to use the *Full IFRS* is the *IFRS for SMEs*; a simplified, self-contained set of accounting principles of 230 pages (but based on the *Full IFRS* of 2800 pages) that is appropriate for smaller, non-listed companies (Flower, 2004; Pacter, 2008; Sanders, Lindberg, & Seifert, 2013). With the *Full IFRS* as a starting point, the IASB took cost-benefit considerations into account and made simplifications or modifications to reflect the needs of users of SMEs' financial statements, The modifications included (i) omitting topics that SMEs are typically not likely to encounter (e.g., EPS, interim financial reporting, segment reporting & accounting for assets held for sale); (ii) simplifying recognition and measurements criteria/principles; (iii) eliminating complex options and mandating the simpler options only, (iii) simplifying many of the principles for recognising and measuring assets, liabilities, income, and expenses; (iv) simplifying redrafting, and (v) reducing disclosure requirements (Jerman & Ivankovič, 2011). It is noteworthy that the *IFRS for SMEs* mandates 300 disclosures compared to 3000 disclosures required by the *Full IFRS*. Also, *Full IFRSs* are numbered as they are published and updated almost monthly; *IFRS for SMEs* are logically structured into 35 sections by topic and updated once every two or three years. Other major differences between Full IFRS and IFRS for SMEs are exhibited in Appendix 1.

While *Full IFRS* were designed to meet the needs of equity and other investors in listed companies; users of the financial statements of SMEs do not generally have those same needs. Rather, users of the financial statements of SMEs are more focused on shorter-term cash flows, liquidity, financial strength (balance sheet), and interest coverage and solvency and credit worthiness issues (Pacter, 2007).

Furthermore, *Full IFRS* are a burden on SMEs; they (*Full IFRS*) contain topics and detailed implementation guidance that generally is not relevant to SMEs. This burden has grown as IFRSs, with passage of time, have become more detailed. As such, a significant need existed for an accounting and financial reporting standard that would meet the needs of users of SMEs financial statements while balancing the costs and benefits from a preparer's perspective. *IFRS for SMEs* was designed to lessen the weight of disclosure for SMEs, while simultaneously adhering to the principles of international standards (Cheney, 2004) With the issuance by the IASB of *IFRS for SMEs* in 2009, tailored for the needs and capabilities of smaller entities; many SMEs around the world have the option of using a much simplified IFRS-based accounting framework to prepare their financial statements.

4. Benefits and Obstacles to SMEs upon Adoption of *IFRS for SMEs*

Marcellan (2009) identifies the benefits accruable to SMEs upon adoption of *IFRS for SMEs* as follows:

a) Since IFRS for SMEs is a globally recognised set of financial reporting standards. SMEs that consistently apply them will improve both transparency and comparability, facilitating access to capital through global lenders and investors.

b) Becoming fluent in IFRS will sooner or later be a prerequisite for accountants to secure a successful career path. SMEs that offer opportunities to work in an IFRS environment are likely to be more appealing to accountants compared to SMEs that continue to prepare accounts according to a local GAAP.

c) Growing companies that are considering listing their SME on a stock exchange might want to consider applying *IFRS for SMEs* as an intermediate step that will facilitate the implementation of *Full IFRS* when it is required to be applied for the purpose of an Initial Public Offer (IPO).

In addition, the ability to compare financial statements prepared in different jurisdictions based on *IFRS for SME* would encourage more cross-border trade and merger/acquisition activity and lower the cost of raising finance (Stokdyk, 2010; Timothy, 2010). Furthermore, other researchers have pointed out the advantages that are offered by a common set of standards such as high-quality information, enhanced comparability, transparency, full disclosure, and financing opportunities (El-Gazzar, Finn, & Jacob, 1999; Joshi & Ramadhan, 2002; Daske & Gebhardt, 2006; Epstein & Jermakowicz, 2007).

From a practitioner's perspective, Price Water house Coopers (2006) and IASB (2007) summarise the practical advantages of adopting *IFRS for SMEs* as follows:

a) Adoption of IFRS for SMEs will ease planned implementation of cross-border acquisitions and initiation of proposed partnerships or cooperation agreements with foreign entities.

b) Adopting *IFRS for SMEs* can help SMEs reach international markets.

c) Adoption of *IFRS for SMEs* will have a positive effect on the credit rating scores of enterprises; this will strengthen SMEs' relationships with credit institutions.

d) Adopting *IFRS for SMEs* would improve SMEs' access to financial funds, help them to penetrate foreign markets and thus improve their financial situation and performance (Perera & Chand, 2015).

On the flip side, there are perceived disadvantages and obstacles of the *IFRS for SMEs* including issues relating to comparability, cost, interpretation and education and training that are discussed by researchers (e.g., Zeff, 2007; Evans, Gebhardt, Hoogendoorn, Marton, di Pietra, & Mora, 2005; Zeghal & Mhedhbi, 2006; Taylor, 2009; Cole, Branson, & Breesch, 2011). Other obstacles relate to converting to new accounting principles that inevitably involves some degree of financial and resource cost, which can sometimes be harder for smaller companies to handle. Other challenges that private businesses may face include the obligation to learn new terminology and accounting techniques and also to make changes to their information systems and accounting software. Management reporting processes may need to be reviewed and businesses may need to collect additional data about some of their transactions (Grant Thornton, 2009; Bunea-Bontas & Petre, 2010). In addition, *IFRS for SMEs* like *Full IFRSs* are imbued with a lot of flexibility and opportunities to apply professional judgment; there is, therefore, a distinct possibility that the same type of transaction entered into by different companies would be reported differently in the financial statements, possibly impacting comparability (Fitzpatrick &Frank, 2009; Zeff, 2007). Moreover, IFRS for SMEs includes a number of references to requirements not having to be applied if they require undue cost or effort to determine; significant judgment by preparers of financial statements is required to ensure consistent and high quality application of the standard.

Furthermore, other researches (e.g., Beale, 2010) contend that the *IFRS for SMEs* is, in most areas, just a cut down version of the *Full IFRS*; requiring complex accounting treatments to fulfil its objectives of comparability and assigning a numerical amount to all assets and liabilities. Opponents to the application of IFRS for SMEs also stress that for companies operating in just one country that have no need for cross-border comparability, the extra burden *IFRS for SMEs* impose on small companies would outweigh any potential benefits.

5. Financial Reporting by Nigerian SMEs

Prior to the adoption of IFRS in Nigeria, all entities (large or small, listed or unlisted) were subjected to the same financial reporting framework; no differential reporting framework was existed between public interest and private entities. The Companies and Allied Matters Act, 2004 (CAMA) required all enterprises, SMEs inclusive, to report on the basis of the Nigerian Statements of Accounting Standards (SAS). The only concession extended to SMEs was permission to file modified financial statements to the Corporate Affairs Commission (CAC) (sections 350-353 of CAMA, 2004). These modified financial statements were to be filed in accordance with Part I of the Seventh Schedule which excluded among others, requirements to disclose Statements of cash flows, Statements of accounting policies, Value added statements and Five year financial summaries. In 2010 the Nigerian Accounting Standards Board (NASB), predecessor of the Financial Reporting Council of Nigeria (FRCN) issued a timeline and a roadmap for mandatory adoption of the IFRS by companies operating in the country. The

Roadmap mandates adoption of *IFRS for SMEs*, and compliance by SMEs in Nigeria by January, 2014 (Note 2).

It should be noted that what constitutes an SME in Nigeria is different from the IASB's definition. According to the Nigerian Roadmap (NASB, 2010), an SME refers to any entity that does not have public accountability and: (1) its debt or equity instruments are not traded in a public market; (2) it is not in the process of issuing such instruments for trading in a public market; (3) it does not hold assets in a fiduciary capacity for a broad group of outsiders as one of their primary businesses, and (4) the amount of its annual turnover is not more than 500 million or such amount as may be fixed by the Corporate Affairs Commission (CAC). Other characteristics of a Nigerian SME are (5) its total asset value is not more than 200 million or such amount as may be fixed by the CAC; (6) no member of Board is an alien; (7) no member of the Board of directors is a government or a government corporation or agency or its nominee, and (8) the directors among their membership hold not less than 51 percent of its equity share capital. Micro-enterprises: users and financial preparers of "one-person enterprises", probably unregistered and operated by its owner, along with perhaps family members and friends, can report using small and medium-sized guidelines on accounting (SMEGA) Level 3 issued by the United Nations (2008). A set of financial statements for Level 3 enterprises includes (a) an income statement (b) a statement of financial position; and (c) explanatory notes, based on a simple accruals accounting approach broadly consistent with IAS 1. The guidance requirements do not involve compliance with specific IFRSs but are based on the historical cost and accruals measurement approach, which is the basis of IFRSs/IASs.

6. Challenges of Adoption of IFRS for SMEs in Nigeria

Several challenges have been identified in the literature (e.g., Odia & Ogiedu, 2013; Ezeagba, 2017) regarding the challenges that confront entities adopting *IFRS for SMEs* in Nigeria.

First, the United Nations (2008) asserted that in developing countries, compliance with IFRS for SMEs is believed to be more difficult than elsewhere because IASB (the standards setters) did not accommodate the peculiarities of developing countries, in terms of their uniqueness and heterogeneous nature (see Simpson, 2008; Oberholster, 1999).

Although IFRS for SMEs are a greatly simplified, self-contained set of accounting principles, their adoption poses a challenge to most of Nigerian SMEs due to the lack of professional ability to cope with even these simplified accounting standards. IFRS skills are at the early stage of being developed in Nigeria and are very scarce and highly competitive. It requires considerable length of time to get the required personnel. Despite that IFRS for SMEs are greatly simplified, their adoption still places a burden on SMEs who have to design, test and implement accounting processes and develop and retain IFRS competencies.

7. Conclusion

This paper reviews literature on financial reporting by private interest entities, particularly the use of *IFRS for SMEs* in Nigeria. Advantages to entities that adopt the full IFRS by publicly accountable entities and *IFRS for SMEs* by private entities are justified and discussed. Regrettably, the paper could not discuss empirical evidence demonstrating the extent to which Nigerian SMEs have achieved any practical advantages of adopting *IFRS for SMEs.* Research studies based on archival "ex post facto" methods are almost non-existent. This may not be unconnected with the fact that SMEs are not obliged to publish their financial reports generally to members of the public; registered but unlisted entities are only obliged to file their financial reports with the CAC. Unregistered "informal" entities do not usually file their financial statements with any regulatory authority at all. Attempts at empirical studies addressing the impact of adoption of *IFRS for SMEs* in Nigeria (e.g., Efeeloo, Barisua, & Neeka, 2017) are based on *ad hoc* questionnaires or interviews soliciting the subjects' opinions regarding the impact of adoption of *IFRS for SMEs*. This paper therefore recommends further empirical "*ex post* facto" research to access the impact of the adoption of *IFRS for SMEs* on financial reporting by unlisted Nigerian enterprises.

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Appendix 1

Major Differences between IFRS for SMEs and Full IFRSs

IFRS for SME			
Section	**Topic**	**Full IFRS Equivalent**	**Key areas of difference between IFRS for SMEs and Full IFRS**
6	Statement of changes income, and retained earnings	IAS 1:Presentation of Financial Statement	"Statement of Income and retained Earnings" is a new statement incorporated in IFRS for SMEs that may be presented in place of Statement of comprehensive income and Changes in equity if the only changes to equity comprise profit or loss, payment of dividends, corrections of prior year errors and changes in accounting policy.
10	Accounting policies, estimates and errors	IAS 8: Accounting policies,, changes in accounting estimates and errors	If the IFRS for SMEs does not specifically address a transaction, other event or condition, an entity's management shall use its judgement in developing and applying an accounting policy. In making the judgement, management shall refer to, and consider the applicability of: (a) the requirements and guidance in the IFRS for SMEs dealing with similar and related issues; and (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 Concepts and Pervasive Principles. Management may also consider the requirements and guidance in full IFRS dealing with similar and related issues, but not mandatory.
11-12	Basic Financial instruments	IAS 39 Financial instruments:	An embedded derivative is separated from the host contract and accounted for as a derivative under IAS 39

	other financial instruments issue	recognition and measurement	under certain conditions. There is no concept of embedded derivatives under the IFRS for SMEs. De-recognition and hedging requirements have been simplified.
14-15	Investments in associates and investments in joint ventures	IAS 28 & 31 Investments in associates and interest in joint ventures	A venturer shall account for all of its interests in jointly controlled entities using either: (a) the cost model; (b) the equity method; or (c) the fair value model. However, the IFRS for SMEs permits the use of the cost model only if a published price quotation is not available, otherwise use of the fair value is permitted.
16	Investment property	IAS 40: Investment property	Under subsequent measurement, investment property whose fair value can be measured reliably without undue cost or effort must be measured at fair value at each reporting date with changes in fair value recognized in profit or loss. An entity accounts for all other investment property as property, plant and equipment using the cost-depreciation-impairment model in Section 17.
17	Property, plant & Equipment	IAS 16: Property, Plant & Equipment	An entity must measure all items of property, plant and equipment after initial recognition at cost less any accumulated depreciation and any accumulated impairment losses. Only the historical cost method is permitted, no revaluations.
18-19	Intangible assets other than goodwill and business combinations & goodwill	IAS 38 Intangible assets	Under IFRS for SMEs, in subsequent measurement, intangible assets are measured at cost less accumulated amortization and impairment losses. It does not permit the application of the revaluation model to intangible assets. Goodwill and intangible assets are amortized over its useful life. If a reliable estimate of the useful life cannot be made, the life is presumed to be 10 years.
20	Leases	IAS 17: Leases	Additional guidance is given on operating leases. Operating leases are expensed on a straight-line basis or another basis that represents the use of the asset, unless payments to the lessor increase with expected inflation, in which case the payments are expensed when payable.

24	Government grants	IAS 20 Accounting for government grants and disclosure of government assistance	An entity shall recognize government grants according to the nature of the grant as follows: a) A grant that does not impose specified future performance conditions on the recipient is recognized in income when the grant proceeds are receivable; b) A grant that imposes specified future performance conditions on the recipient is recognized in income only when the performance conditions are met; c) Grants received before the income recognition criteria are satisfied are recognized as a liability and released to income when all attached conditions have been complied with.
25	Borrowing costs	IAS 23 Borrowing costs	All borrowing costs are expensed in profit or loss in the period in which they are incurred
26	Share-based payments	IFRS 2: Share-based payments	The IFRS for SMEs uses a hierarchy to determine the fair value of shares issued based on: a) Observable market prices; b) If unobservable, entity specific observable market data, such as a recent transaction in the instruments or a recent independent valuation of the entity; c) If the fair value is not observable and obtaining entity specific market data is impracticable, the directors should use their judgement to apply the most appropriate valuation methodology.
28	Employee Benefits	IAS 19: Employee Benefits	All actuarial gains and losses must be recognized in full either in profit or loss or in other comprehensive income. Post-retirement defined benefit plans recognition and measurement are significantly different to IFRS.
29	Income tax	IAS 12: Income taxes	Deferred tax assets have to be recorded under the IFRS for SMEs with offsetting valuation allowances (this is not included in IAS 12). “Uncertain tax positions” recognition and measurement have been incorporated in the IFRS for SMEs.
30	Foreign currency	IAS 21: The effects of changes	Exchange differences on monetary items are recognized in profit or loss for the period except for those

translations	in foreign exchange rates	differences arising on a monetary investment in a foreign entity (subject to strict criteria of what qualifies as net investment). In the consolidated financial statements, such exchange differences are recognized in other comprehensive income and reported as a component of equity

Sources: Perera and Chand (2015); Pacter, (2008); Marcellan (2009).

Note(s)

Note 1. Dikko Radda is the Director General of the Small and Medium-sized Enterprises Development Agency (SMEDAN), a Nigerian government agency charged with responsibility of growing SMEs.

Note 2. Adetula, Owolabi, & Onyinye. (2014). Reported that a major factor responsible for IFRS adoption by SMEs in Nigeria was that other countries around the world are adopting it.