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Implementing IFRS for SME - a Challenge for Albania

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Abstract

Recently Albania has implemented international accounting standards for public interest entities, such as second tier banks, insurance and reinsurance companies and several entities that are important because of their turnover and/or employment and national accounting standards for the rest of the entities.

International Accounting Standards Board (IASB), as the highest body which has the authority to design these international accounting standards, has issued another standard for entities not listed in stock market, classified as medium or smaller ones or non public interest entities . The main concern in Albanian context is whether this standard should be implemented by replacing the current national accounting standards, or whether our local standards should be amended.

Getting together confidential financial information in a large range is challenging and difficult. It is even more difficult considering our country has only two decades of a free market economy and a poor inheritance in the tradition of financial information publication. This paper discusses the challenge of IFRS-for-SME implementation and presents a case study to show how this framework may effect the reporting requirements. Furthermore, in addition to literature review we have used the financial information of one company to analyse and to demonstrate the differences arising by the two different frameworks. This paper tries to take into consideration the effects which will associate the changes from local standards to IFRS-for-SME; the effects that it will have in different sectors of the economy, how such change is reflected in the work of professional accountants, and the necessary steps for such accounting changes. This study serves as a good starting point for further advanced studies on this topic.

Keywords: IFRS for SME, NAS, National Accounting Standards, NACA.

1. Introduction

Financial reporting of business entities in Albania is regulated under the "Law for Accounting and Financial Statements". The law settles the requirement criteria and serves as a guide for entities which are required to use IFRS or National Accounting Standards for such reporting. Criteria's specified in this law became mandatory as of January 2008.

Such a new development in the accountancy area is as a result of the requirements of "Stabilisation Association Agreement" SAA. One of the requirements of the SAA was the harmonisation of the local legislation with the EU legislation in the field of economy and trade. Referring to this agreement Albania should accomplish the obligation for implementing the international accounting standards for the entities operating in an international environment listed in official stock market.

The international accounting standards issued by IASB, as the highest body which has the authority to design these international accounting standards, has been translated without changes from the original text under the responsibility of The National Accounting Council of Albania, NACA. NACA has designed and published local accounting standards NAS1-14 which is applicable for SMEs and NAS 15 as a stand alone standard that is applicable for micro entities.

IASB in July 2009 has issued as a stand alone document "International Financial Reporting Standards for Small and Medium-sized Entities" for

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entities not listed in stock market, classified as medium or smaller ones. This standard is not yet mandatory in the EU countries.

There have been various opinions, for and against, whether such a standard should be mandatory or not for those entities not listed in stock markets, which are classified as small or medium. Some of the reasons in favour of IFRS-SME:

The large number of small and medium enterprises.

Only one or two employees is employed in each of these entities.

It is a considerable cost for each country to design and implement its own local standards.

The prospective of Small and Medium Entities is the integration within the international markets[3] .

A relevant matter to be considered is whether this standard should be implemented in Albania by replacing the current national accounting standards, which will facilitate Albania operating under common EU financial reporting standards, or whether our local standards should be amended? In order to answer this question, we have to conduct analysis on differences that exist between NAS and IFRS-SME based on quantitative and qualitative differences.

2. Material and Methods

To investigate the differences between implementation of IFRS for SME versus national accounting standards, paragraphs of IFRS for SME are compared to each national standards that compiles the SME requirements for financial reporting. The National Accounting Standards are composed of a set of standards where each standard is specific for a certain item whereas IFRS for SME is one standard composed of 35 sections covering the respective items. Furthermore, the reporting of financial information by implementing the both IFRS for SME and NAS in a real Albanian enterprise will reveal the differences and conclude on prons and cons of implementing the IFRS for SME in Albania.

There are several differences between the two frameworks and below we show some of the most relevant ones. An entity reporting under IFRS-SME[2] shall prepare the following financial statements:

1. The statement of financial position;
2. The statement of comprehensive income and an income statement;
3. The statement of changes in equity or a statement of income and retained earning;
4. The statement of cash flows; and
5. The notes of the financial statements (summary of significant accounting policies and other relevant explanatory information)

For Financial Statements prepared under IFRS-SME [2] reporting framework, it is necessary to provide details of who authorised the statements and the date they were authorised; such information is not specifically required under local standards. Knowledge of the date that Financial Statements were prepared is essential in considering events after the reporting period which may or may not be reflected in those statements. Lack of such information may mislead the judgment of users of the Financial Statements regarding events after the reporting period which may or may not be corrected.

Under NAS requirements an entity should prepare five financial statements whereas under IFRS-SME except the set of financial statement given above in the second paragraph of this section, there is a specific case where an entity may prepare four financial statements because the statement of income and retained earning can be shown below the profit for the period: Paragraph 3.18[2] (section "Financial Statement Presentation" IFRS-SME) specifies that "if the only changes to equity during the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period errors, and changes in accounting policy, the entity may present a single statement of income and retained earnings in place of the statement of comprehensive income and statement of changes in equity" [2].

Under IFRS-SME the following information should be presented in the statement of income and retained earnings :

- The retained earnings at the beginning of the period;
- The dividends declared or payable during the period;
- The restatements of retained earnings by correcting the errors;
- The restatements of retained earnings for changes in accounting policies; and
- The retained earnings at the end of the period.

We should note that the statement of income and retained earnings is prepared only as a result of a change in the above items.

There are some items which are presented in the statement of comprehensive income and not in the income statement namely:

- The profit/loss from foreign currency translation[2] (section 30 “Foreign Currency Translation IFRS-SME);
- The actuarial gains and losses[2] (section 28 “Employee Benefits” IFRS-SME) [2];
- The profit/loss from hedging instruments recognized with fair value [2] (section 12 “Other Financial Instrument Issues” IFRS-SME).

Under NAS (NAS2 respectively), these items will not be presented in the income statement.

In contrast to IFRS-SME [2] , in NAS12 translation of financial statements in foreign currencies other than functional currency is presented at “exchange differences not realised” which is positioned in the statement of financial position part of own equity.

With consolidation under IFRS, a parent entity prepares only consolidated financial statement whereas under NAS a parent entity prepares its individual financial statements as well as consolidated financial statements for the entire group.

Unlike in NAS, in IFRS-SME an entity which has restrictions on the transfer of funds or assets is not excluded from consolidation [2] (section 9 “Consolidated and Separate Financial Statements” IFRS-SME).

Unlike NAS, in IFRS-SME [2] financial statements of the same investor (business owner) are not consolidated.

In IFRS-SME, financial assets and liabilities are addressed separately in two different sections, section 11 deals with basic financial instruments recognised according to the cost model and section 12 addresses other complex financial instruments recognised according to fair value model. In local standards these are addressed in NAS3 without any specific explanation on measurement and presentation. The only case when a company is allowed to avoid application of full provisions for both sections [2] (11 and 12) is when the entity chooses to apply the recognition and measurement provisions settled in IAS 39 with the condition that the disclosure requirements should be addressed in section 11 and 12. Local standards allow such treatment in all cases.

Financial instruments which are addressed in section 12 of IFRS-SME are measured with fair value by transferring the differences at profit and loss account. For such instruments hedging accounting is applied. This section excludes instruments for which fair value cannot be reliably measured, which are measured at cost.

Equity instruments are treated in a different section [2] (section 22 “Liabilities and Equity” IFRS-SME) in contrast with NAS3 where there is no difference implied between equity instruments. This section gives a clear picture, by classifying the instruments as either liability or equity. In cases when an entity issues equity instruments before collecting the cash, the receivable amount is presented as compensation in equity and is not presented as an asset item, whereas in NAS such amounts are presented as assets in “unpaid capital”.

Deferred taxes are obligatory under the IFRS-SME [2] reporting framework in contrast with local standards (NAS 11) where application of such an approach is not mandatory. Mandatory implementation of deferred taxes requirement (in IFRS-SME) will lead to a reduction of the differences between fiscal and accounting profits.

IFRS-SME presents an overdraft as a borrowing item whereas local standards (NAS2) allow presentation in the cash and cash equivalent item.

Accounting of subsidiaries and joint ventures under IFRS-SME are recognised with cost or fair value method in contrast to NAS 14, where accounting for subsidiaries is recognised with equity method (joint ventures are not included there).

Biological assets at each reporting date are measured on the basis of fair value less cost of sales in contrast to local standards (NAS 13) where the measurement is done at cost and at the end of the period noncurrent biological assets should be tested for impairment. Under the IFRS-SME framework, the cost model is allowed only for those cases when fair value cannot be reliably measured and there is no additional cost. Agricultural products collected from biological assets are initially recognized with fair value less cost of sales in the collection place, in other words with NRV [2] . In local standards those assets are measured at cost.

In IFRS-SME, Property plant and equipment are initially recognized at cost excluding borrowing cost. This is a significant difference because in contrast to the local accounting standards (NAS5), in IFRS-SME borrowing cost are recognized as expenses for the period regardless of the purpose of the borrowing.

In IFRS-SME, property plant and equipment after initial recognition are measured using the cost model (historical cost less accumulated depreciation and any impairment), whereas in NAS 5 these assets are measured using the cost model or fair value model. It means that IFRS-SME does not allow overestimation of assets. Property plant and equipment must be tested for any impairment every year, whereas in NAS 5 they are tested every three or five years.

Intangible assets, such as research and development, are recognized as expenses under IFRS-SME reporting framework. NAS recognize the expenses for research as expenses for the period and development expenses are capitalized under this framework. In IFRS-SME [2] , if the useful life of an intangible asset cannot be reliably measured or is infinite, then it should be considered as ten years, thus the intangible asset should be depreciated over ten years. Goodwill under this framework (IFRS-SME) is treated in a similar way; if its life cannot be measured reliably, then it will be assumed to have a ten year life. This differs from local standards where goodwill is not depreciated but only is tested for impairment.

3. Results and Discussion

Local standards do not specify the treatment for some cases. This creates a gap for the entities which may have any of these issues.

IFRS-SME, requires an entity to prepare a new financial statement, namely the statement of comprehensive income.

IFRS-SME specifies that financial statement, should give information on the resources which are owned by third parties. I.e, resources entrusted to the entity by specific outsiders like clients or other stake holders not involved in management.

The financial information presented in these financial statements must have the quality of "Timeliness" which means that information must be able to influence the economic decision of users by providing the information within the decision time frame. An entity shall disclose, in the summary of significant accounting policies or other notes, the judgments that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognized in the financial statements. Investments in Joint Ventures are treated in a special section within IFRS-SME[2] (section 15). These investments can be accounted by one of three models, the cost model, the equity method or the fair value model. Investment property is not treated at all under NAS. Investment property covers property (land or building, part of a building, or both) held by the owner or by the lessee under a finance lease to earn rent or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes, or sale in the ordinary course of business. An entity shall measure investment property at its cost at initial recognition and later at fair value at each reporting date with changes in fair value recognized in profit or loss. In the case of sales and lease back, if the price from sale is higher than net book value this difference shall amortize such excess revenue over the lease period. This treatment is not presented under NAS 7. The entity must exclude the expected profit from disposal of assets when measure a provision. This is not treated under NAS. Share based payment transactions are treated in a special section under IFRS-SME framework whereas NAS do not treat them. Employee Benefits under IFRS-SME are treated in a special section classified as either defined contribution plans or defined benefit plans, depending on their principal terms and conditions differently. Under NAS these liabilities are not treated. Hyperinflation is treated under IFRS-SE in a special section; this matter is not treated under NAS. Specialised activities such as agriculture, extractive industries (mining) and service concessions are treated together in a special section on IFRS-SE. Such activities are not treated under NAS, which can cause problems for entities that do not meet full IFRS criteria. First time adaption of IFRS-SE is treated in a particular section [2] (section 35 "Transitions to IFRS for SMEs"). According to this section, financial statements should be prepared in accordance to IFRS-SE at least for the two previous years. In the local standards there is no disclosure about first time adaption of NAS.

We have used the financial information of one company to analyse and to illustrate the differences arising by the two different frameworks. Taking consideration of the confidentiality of the information and anonymity from the company we will use only the figures of one period.

Table 1: Extract form trial balance (in 00`); Adjusted trial balance under the two different frameworks (in 00`)

Trial Balance	Values	Effect [2]	NAS Recognition	IFRS-SME Recognition	NAS Final	IFRS-SME Final
Cash and cash equivalents	1,524,116	4	80,000	80,000	1,604,116	1,604,116
Trade receivables	1,301,986	5	10,000	10,000	1,311,986	1,311,986
Other accounts receivable	299,895				299,895	299,895
Goods	441,416				441,416	441,416
Prepayments & deferrals expenses	1,834,728				1,834,728	1,834,728
Property Plant and Equipment	945,224	1	110,000	100,000	1,055,224	1,045,224
Property	300,000	3	200,000		500,000	300,000
Development expenses	486,764	2		(486,764)	486,764	-
Equity receivable		4	20,000		20,000	-
Trade payables	(3,626,291)				(3,626,291)	(3,626,291)
Interest payables		1	(10,000)	(10,000)	(10,000)	(10,000)
Bank loan		1	(100,000)	(100,000)	(100,000)	(100,000)
Current tax liability	(244,150)				(244,150)	(244,150)
Share capital	(1,235,171)	4	(100,000)	(100,000)	(1,335,171)	(1,335,171)
Shares issued but not paid		4		20,000	-	20,000
Surplus from impairment		3	(200,000)		(200,000)	-
Retained earnings	(965,456)	5		(10,000)	(965,456)	(975,456)
Profit (Loss) for the period	(1,063,061)				(1,073,061)	(566,297)
Revenue	(2,896,136)	5	(10,000)		(2,906,136)	(2,896,136)
Other income	(1,551,444)				(1,551,444)	(1,551,444)
Raw material &consumables used	2,635,128				2,635,128	2,635,128
Employee salaries and benefits	454,146				454,146	454,146
Depreciation & amortization expense	47,964				47,964	47,964
Development expenses		2		486,764	-	486,764
Other expenses	215,733				215,733	215,733
Financial cost and income	(7,112)	1	-	10,000	(7,112)	2,888
Other financial cost and income	38,660				38,660	38,660

The cases shown below represents a combination of real situations as well as simulated ones. For simplicity, the figures associated with these cases are modified.

The following paragraph shows some of the transactions which can be treated differently under the two frameworks.

1. Entity has received from the bank a loan of ALL 10,000,000 with an interest rate approximately 10 % (approximately ALL 1,000,000) to purchase a fixed asset. Under NAS, interest expenses are going to be capitalized. IFRS-SME framework recognizes interest expenses as expenses for the period.
2. Entity has development expenses of ALL 48,676,400. IFRS-SME recognizes such expenses in profit and loss statement as expenses for the period.
3. At the end of the year, the land was revalued up by ALL 20,000,000. Under NAS, The entity measures its property plant and equipment using the revaluation model where a revaluation surplus of ALL 20,000,000 is generated, whereas in IFRS-SME this model is not allowed.
4. During this period the entity issued additional shares for ALL 10,000,000. The entity has collected only 80% of the amount. The amount to be received under NAS is classified as a separate asset item, instead IFRS-SME presents this amount as a compensation item in equity

5. During the control the entity realized that it has forgotten to register three sales invoices which amount a total of ALL 1,000,000 from the previous period. This amount is not material. IFRS-SME stated that this error should be corrected when incurred. NAS does not allowed retrospective correction of

such errors.

The next step after recognising the above transactions in compliance with each framework is the presentation of financial statements. Another matter to be considered is that the entity has an overdraft of ALL 20,000,000.

Another relevant issue is that under IFRS-SME there is no need to prepare a statement of movement in equity when these movements are presented in the statement of income and retained earnings.

Table 2 presents extracts from the Balance Sheet[1] (NAS) in the left side and Statement of Financial Position [2] (IFRS-SME) in the right side. Table 3 presents extracts of Income Statement [1] (NAS) in the left side and Statement of Comprehensive Income and Retained Earnings [2] (IFRS-SME). As you can clearly see, total assets and profits for the period under NAS are overstated.

4. Conclusions

The National Accounting Standards of Albania and IFRS for SMEs are designed to align with the full IFRS. NAS are designed and issued by NAC rather whereas IFRS for SMEs is designed and issued by IASB. Both these standards compete with each other. From our analysis IFRS-SME has more advantages and is preferred to NAS. Our study shows the following reasons for this preference:

- ✓ IFRS-SME is more complete and there are certain cases which are not treated under NAS;
- ✓ In some cases IFRS-SME is much more practical and simple to comply with;
- ✓ IFRS-SME appear to provide a better comprehensive information (with different examples for the respective sections) for implementation.

Table 2: Extract from balance sheet (in 00`)*

Balance Sheet (Asset) – NAS (in 00`)		**Statement of Financial Position (Asset) – IFRS-SME** (in 00`)	
ASSETS	**Value**	**ASSETS**	**Value**
Current assets		**Current assets**	
Cash and cash equivalents	1,604,116	Cash	1,804,116
Derivatives and financial assets held for sale	-	Trade and other receivables	1,611,881
Other short term financial assets	1,611,881	Inventories	2,276,144
Trade receivables	*1,311,986*		**5,692,141**
Other accounts receivable	299,895	**Noncurrent assets**	
Inventories	2,276,144	Investment in associate	-
Goods	*441,416*	Property Plant and Equipment	1,345,224
Prepayments and deferrals expenses	*1,834,728*	Intangible assets	-
Short term biological assets	-	Deferred tax assets	-
Short term assets held for sale	-		**1,345,224**
Prepayments	-	**Total assets**	**7,037,365**
Total current assets	**5,492,141**		
Noncurrent assets			
Long term financial assets	-		
Property Plant and Equipment	1,555,224		
Property	*500,000*		
Other PPE	*1,055,224*		
Long term biological assets			
Intangible assets	486,764		
Development expenses	*486,764*		
Equity receivable	20,000		
Other long term assets			
Total of long term assets	**2,061,988**		
TOTAL ASSETS	**7,554,129**		

*For the balance sheet prepared under National Accounting Standards of Albania is used the same format disclosed in NAS2 “Presentation of Financial Statement” (page 22, 31). We did not make any amendment to this format.

Balance Sheet (Eq.& Liab.) – NAS (in 00`)		**Statement of Financial Position (Liab. & Eq.) - IFRS-SME** (in 00`)	
EQUITY AND LIABILITIES		**LIABILITIES AND EQUITY**	
Derivatives		**Current liabilities**	
Borrowings	100,000	Bank Overdraft	200,000
Prepayments	3,880,441	Trade payables	3,626,291
Trade payables	*3,626,291*	Interest payable	10,000
Other payables	*10,000*	Current tax liability	244,150
Tax Payables	*244,150*	Provision for warranty obligations	
Grants and deferrals income		Current portion of employee benefit obligations	
Short term provisions		Current portion of obligations under finance leases	
Total Current liabilities	**3,980,441**		**4,080,441**
Noncurrent liabilities		**Noncurrent liabilities**	
Long term borrowings		Bank loan	100,000
Other long term borrowings		Long term employee benefit obligations	
Long term provisions		Obligations under finance leases	
Grants and deferrals income			**100,000**
Total noncurrent liabilities		**Total liabilities**	**4,180,441**
Total liabilities	**3,980,441**	**Equity**	
Equity		Share capital	1,315,171
Share capital	1,335,171	Retained earnings	1,541,753
Treasury shares			**2,856,924**
Surplus from impairment	200,000	**Total equity and liabilities**	**7,037,365**
Statutory reserves			
Legal reserves			
Other reserves			
Retained earnings	965,456		
Profit (Loss) for the period	1,073,061		
Total Equity	**3,573,688**		
TOTAL EQUITY AND LIABILITIES	**7,554,129**		

IFRS-SME does not disclose any standard format but it gives guidance on compliance with IFRS for SMEs. IFRS-SME gives the principles for preparation of financial statements and which items should be disclosed in those statement.

Table 3: Extract from Profit and Loss (in 00`)

Income statement (in 00`)		**Statement of comprehensive income and retained earnings** (in 00`)	
Revenue	2,906,136	Revenue	2,896,136
Other income	1,551,444	Other income	1,551,444
Changes in inventories of finished goods and work in progress		Changes in inventories of finished goods and work in progress	
Worked performed by the entity and capitalized		Raw material and consumables used	(2,635,128)
Raw material and consumables used	(2,635,128)	Employee salaries and benefits	(454,146)
Other operating expenses	(215,733)	Depreciation and amortization expense	(47,964)
Employee benefits expense	(454,146)	Impairment of Property plant and equipment	
Depreciation and amortization expense	(47,964)	Other expenses	(702,497)
Profit (Loss) from operating activity		Finance cost	(41,548)
Finance cost and income	(38,660)	Profit before tax	566,297
Profit (Loss) from exchange rate		Income tax expense	
Other finance cost and income	7,112	Profit for the year	566,297
Profit (Loss) before tax	**1,073,061**	Retained earnings at start of year	965,456
Income tax expense		Errors	10,000
Profit (Loss) for the period		Retained earnings at end of the year	**1,541,753**

Professional Accountants in Albania are still unfamiliar with NAS and they need support and interpretation for some situations.

The update of IFRS-SME will be made by IASB every three years leaving a year for their implementation, while NAS have been implemented for over three years and there have been no amendments so far.

Following the update in the 4th and 7th directive, the EU will encourage implementation of IFRS-SME [4]. On the other hand, implementation of IFRS-SME in Albania will require all entities to prepare their financial statements according to international standards regardless of their size.

Results from the case study show different balances under two frameworks and based on these results it seems that IFRS-SME is much more conservative that NAS. As it is pointed out in the abstract of this material we hope that this paper serves as a good starting point for further advanced studies.

Implementing a new standard, even when necessary, is not easy because it is involves political, social, and economic considerations. It is a political decision because it is necessary to make amendments in the law. It has social and economical cost not only for the need to train the professional accountants, but also the implementation of new standards will be associated with a different treatment approach on the financial information of the entities.

What we suggest to the parties with influence on such decision making (e.g. NACA and other related parties) is that if such a step is going to be taken then it should be taken in consideration other steps and factors in order that such implementation became successful, in time as well as find the professional accountants familiar with this standard . Of course this is a challenge in the field of accounting. If such a challenge is achieved it will help Albania to operate under a common EU financial reporting standards.

5. Acknowledgements

This paper is based on the published National Accounting Standards in the official website of National Accounting Council and on the published International Financial Reporting Standard for Small and Medium size Entities in the official website of International Accounting Standard Board. The comparisons, analysis, interpretations, and comments (except comments referenced 6, 20) are all as a result of the work of the authors.

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