

Financial reporting and mimetic theory for small and medium enterprises

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This study demonstrates that in spite of the complexity of the International Financial Reporting Standards for small and medium enterprises which outweighs the accounting expertise and the level of business growth encountered in emergent countries, and of the tentative opinions expressed by certain groups of regulators, preparers of accounts and financial reporting users on the adequacy of implementing the standard in the pre-issue period, the regulators from emergent countries significantly adopted it in the post-issue period. The argument lies in the mimetic theory which suggests that emergent countries tend to embrace unreservedly the concepts or trends supported by majority groups or originating from developed countries.

Keywords: Emergent countries, financial reporting, mimetic theory, small and medium enterprises.

SMALL and medium-sized enterprises (SMEs) (see note 1) have an increasing contribution in generating wealth both in developed and emergent economies¹⁻³. However, SMEs are not as broadly represented in the international economy as large entities^{3,4}. The literature on international entrepreneurship refers to the barriers faced by these entities when entering the global economic scene³⁻⁶, including the lack of information or national and international administrative rules and regulations. Financial reporting (accounting information) represents a contingency variable of internationalization^{7,8}, its quality having a positive influence on the growth of SMEs.

The G20 London Summit on strengthening the financial system⁹ advocates a single set of high-quality global accounting standards, including standards for SMEs, in order to improve the transparency and quality of accounting information. A uniform financial reporting system can provide a series of knowledge-related advantages and a method for simplifying the national and international administrative rules and regulations⁶. The present study tests the capacity of the standard drafted by the International Accounting Standards Board (IASB) and dedicated to SMEs, i.e. International Financial Reporting Standards (IFRS) for SMEs, to meet these requirements.

Certain opinions in the accounting literature are critical towards the implementation of a new accounting standard which could incur high costs for SMEs, thus reducing their development¹⁰. The disadvantage of switching to a

new set of rules is more significant for emergent countries, all the more so, as the IFRS for SMEs is said to be too complex and difficult to put into practice, considering that these countries do not possess sophisticated accounting systems like the developed countries.

This study examines the manner in which the advantages and disadvantages of implementing the IFRS for SMEs have been adopted in different countries, with focus on the diverging standpoints between developed and emergent countries. The study uses mimetic theory in order to explain the approach of emergent countries, which seems to be in favour of implementing the international regulations despite the difficulties mentioned in the literature for these economic environments. This study also aims to see if the favourable attitude goes as far as accepting the IFRS for SMEs without a thorough analysis, without consideration of the fact that this standard could be further simplified or that it is only adequate for certain groups of SMEs. In order to reach this aim, an *ex-ante* analysis has been conducted first, a review of the comment letters regarding this standard, using statistical techniques for data processing. Then, through an *ex-post* analysis, the findings have been correlated with the actual actions triggered by IFRS implementation between 2009 and 2013.

SMEs financial reporting

Growth and financial reporting quality

SMEs cannot be considered as large entities on a smaller scale¹¹ because of the differences in management structure and organization, means of financing, a more reduced complexity of the operations plus a more reduced risk of

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internal and external moral hazard^{12,13}. This implies the inadequacy of practices of large entities for smaller entities, including the financial reporting standard^{12,14}.

According to the decision-usefulness theory¹⁵, the quality of the financial information has a positive influence on the decisions of its users, which is correlated with growth of SMEs, with McMahon¹⁶ concluding that the growth of SMEs is a key driver to more sophisticated financial reporting practices.

As a result, financial reporting quality supports the internationalization of SMEs as a way of growth for these entities. The core of knowledge theory, namely that newly developed international expertise and skills enable entities to overcome the risks and disadvantages of foreignness¹⁷, can be extended to the financial reporting system, which once known for a given country, becomes an influential factor of information management and an advantage for future enhancements. De Clerq *et al.*¹⁸ showed that the uncertainty perceived when accessing new markets can be diminished by means of information exchange with organizations that are more familiar with the local background. Hollenstein⁵ found that advantages related to wages and regulations in general are a decisive factor for internationalization of SMEs.

Considering the correlation between the growth of SMEs and the quality of financial reporting, the opportunity to adopt an international accounting standard is more auspicious for entities that have established a development strategy, including through internationalization, and for entities belonging to the category of larger SMEs.

IFRS for SMEs

IFRS for SMEs, the most representative standard designed for SMEs, was published by IASB in July 2009 to address non-publicly traded entities. Introduced in 2003, the standard went through the stages of discussion paper (2005), exposure draft (2007), and surveys and field tests applied worldwide (2008–2009). The coordinates of the IASB project can be summarized as follows: the standard is less than 15% of the full IFRS, eliminating more than three-quarters of their requirements; on the technical level, it contains both a change in the disclosure requirements and in those of recognition and valuation; on the conceptual level, it offers a section dedicated to concepts and pervasive principles. The final version of the standard was changed compared to the 2007 version through the elimination of some complex options (financial instruments and accounting for income taxes), the omission of some topics that a typical SME is not likely to encounter (interim financial reporting), and additional simplifications concerning disclosure requirements¹⁹. After its issue in 2009, increasing number of countries have adopted the standard. IASB reports that to date 62 jurisdictions implement the standard and another 16 are considering the standard²⁰.

Research design

Research objective

The advantages of implementing a single international accounting standard, especially IFRS for SMEs, generally valid for SMEs need to be tested for emergent countries. Son *et al.*² argue that in an emergent country context, management of SMEs should improve financial reporting in order to grow in a rapidly changing environment. Also, outward investing, correlated with adequate financial reporting, is recommended to SMEs located both in developed and emergent countries as one of the means of enhancing foreign competition and liberalized global markets³. The World Bank and other international organizations consider IFRS for SMEs as a means to bring capital into emergent economies²¹.

However, as regards the adoption of full IFRS, some concerns were expressed by emergent countries, mainly due to higher costs compared to benefits^{22–24}. The implementation costs relate to training, instruction on IFRS adoption and translation of current IFRS, changes in software systems, double-purpose accounting and deadlines for IFRS adoption and consulting services²⁵. The estimated costs are more burdensome for SMEs than for large companies, up to 0.31% of turnover in small companies vs 0.05% of turnover in large companies²⁶. These findings could be extrapolated to IFRS for SMEs. Also, certain objections were raised against IFRS for SMEs concerning its complexity and sophistication^{27,28}. This criticism is related to the fact that these countries and their business entities may not possess the resources required by such financial reporting.

First, this article attempts to analyse the degree of acceptance of IFRS for SMEs by the representatives of each type of economy, emergent and developed, and their motivation. Secondly, these approaches are compared to the version in which the international standard was adopted by emergent countries and their main reasons to act in such manner, in the period following the issue of the standard. Despite all the advantages mentioned by IASB and supported by certain opinions, the literature still argues that IFRS for SMEs does not trigger sufficient simplification in order to reduce the administrative burden for such entities and countries. A possible favourable attitude of the respondents of these countries towards the international standard could be explained based on the mimetic theory.

The mimetic theory authored by René Girard in 1978 (ref. 29) and applied in several areas of activity could be useful to economics as a new application. It is based on the principle that human beings are mimetic creatures. According to Girard *et al.*³⁰, we look at others to be taught what to value and who to be; we imitate our model's thinking. Anspach³¹ affirms that in fact we learn our desires from others. It is the desire of every one to excel over everyone else in the accumulation of goods.

DiMaggio and Powell³², who developed the concept of mimetic isomorphism in 1983 as part of the new institutional sociology, point out the cause of mimetic processes, namely uncertainty, which encourages imitation. Organizations may model themselves on other organizations when, for example, the organizational technologies are poorly understood or when goals are ambiguous. When applied to companies, the theory shows how based on institutional isomorphism later entrants tend to follow the entry mode patterns established by earlier entrants. This study applies the mimetic theory at the institutional level of the accounting standard setters that decide the implementation of IFRS for SMEs.

Data

For the *ex-ante* analysis performed, IFRS for SMEs exposure draft (ED) was considered as the case study in order to determine a first reaction from respondents of emergent countries. A qualitative approach was used based on the examination of documents and statistical tests. A content review of the comment letters (CLs) to the ED was performed, selecting initially 131 responses from the 162 CLs given by the representatives (original respondents, regulators, international audit firms and others) from 45 countries on the list published by IASB³³. The responses that were focused only on one or two items for discussion (19 CLs), and those given in languages other than English (nine CLs) were excluded from the analysis. The type of analysis was underlying themes^{34,35}, following direct answers to specific questions from ED of CLs, as well as free presentations by the respondents, found either in the introduction of their response or in the comments provided in respect to the sections of the entire document. The following analysis topics were selected: (a) general perception of respondents regarding the quality of IASB's IFRS for SMEs (symbolized GP); (b) opinion of respondents regarding the rules for recognition and measurement and (c) opinion of respondents regarding the disclosure rules.

The analysis topics took into account the objectives of the study and the type of questions asked by the Board. Thus, the questions were differentiated as being related to content or to form, the latter being excluded from the study. Form-related questions were those concerning the delimitation of IFRS for SMEs from the full IFRS (Q1, Q4, and Q7) and those that try to solve later implementation problems (Q8, Q10, Q11). Finally, Q5, borrowing costs, is a question of content, but since it received almost unanimous consent from the respondents, it was considered less useful for the analysis. The questions that remain to be processed are the questions of content: Q2, Q3, Q6 regarding the rules of recognition and measurement (b), and Q9, addressing disclosure issues (c).

The analysis topic (b) was detailed into the following elements: Q2 *Recognition and measurement simplifica-*

tions that the Board adopted – Are there other elements which should be taken into consideration?, differentiated by such elements as: general assessment (Q2G), financial instruments (FI), goodwill (GW), investments in associates and joint ventures (JV), employee benefits (B), fair value (FV); Q3 *Recognition and measurement simplifications that the Board considered but did not adopt – Should any of those be reconsidered?* with the elements: general assessment (Q3G), cash flow statement (CF), deferred taxes (DT), consolidated financial statements (C), share-based payment (SP); Q6 *Topics not addressed – Should any additional topics be omitted from the IFRS for SMEs and replaced by cross-reference with full IFRS?*, divided into: general assessment (Q6G), financial reporting in hyperinflationary economies (HI), segment reporting (SR) earnings per share (ES), insurance contracts (I), interim financial reporting (IR). The responses were coded according to their direct message and their interpretations as disagreement and agreement.

The *ex-post* analysis of IFRS for SMEs relied on the IASB 2012 survey addressed to standard-setting and other relevant bodies (IASB, 2014)²⁰, and on data from other international organizations. The analysis took into consideration responses to the survey given by countries that decided to adopt the IFRS for SMEs as an obligation or possibility, for specific categories of SMEs. We established separation criteria for the responses from emergent countries, useful to the research objective; particularly we considered responses that clarified the reasons for implementation by mentioning: specific requirements for implementation, certain categories of SMEs that should apply the standard or responses regarding the changes triggered by the standard.

Results

Ex-ante analysis results

For processing the database obtained by the CL content analysis (see note 2), the principal component analysis (PCA) multivariate statistical technique was used. PCA is mathematically defined as an orthogonal linear transformation that transforms data to a new coordinate system so that the greatest variance by some projection of the data comes to lie on the first coordinate (called the first principal component), the second greatest variance on the second coordinate, and so on³⁶. Mathematically, the transformation is defined by a set of p -dimensional vectors of weights or loadings $u = (u_1, u_2, \dots, u_p)$ that map each row vector $X(i)$ of X to a new vector of principal component scores $C = (C_1, C_2, \dots, C_p)$, given by $C_i = x_{i1}u_1 + x_{i2}u_2 + \dots + x_{ip}u_p$. In this article C_1 and C_2 take on 41.235% of variance, as the Kaiser–Meyer–Olkin measure of sampling adequacy test (KMO = 0.725, Sig. = 0.000) indicates a good quality analysis.

By checking the contribution of the variables to the overall quality of the model, 15 out of 19 variables were considered active or discriminated in a significant manner on at least one of the dimensions created. The general perceptions on the full IFRS for SMEs (GP) respectively on questions Q2 (Q2G), Q3 (Q3G), Q6 (Q6G), had a very small contribution to the inertia of the dimensions and affected the global quality of the analysis. Based on Figure 1 based on the mean frequency of the active variables, dimension 1 discriminates almost all the variables, grouped together, which shows a homogeneity of the opinions of the respondents regarding the level of current and potential simplification of IFRS for SMEs. Dimension 2 discriminates three variables that belong to Q2, also grouped together. Overall, the standard seems to be accepted by respondents from different countries and categories (regulators, users, preparers) as their answers are situated in the quadrant for favourable and partially favourable answers.

The result of the analysis conducted on opinions differentiated according to the category of the country

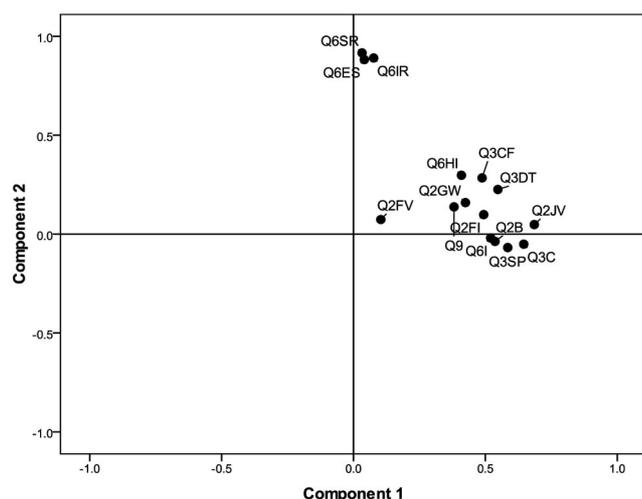


Figure 1. Discrimination measures.

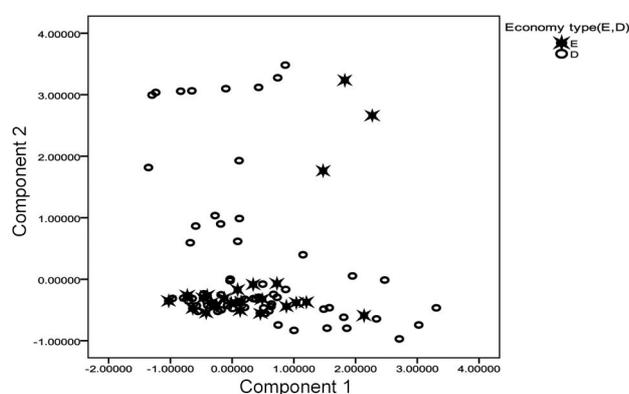


Figure 2. Responses by countries.

emergent (E) and developed (D) is presented in Figure 2. This shows a clear homogenous group of answers from emergent countries in the quadrant for neutrality concerning the adequacy of existing simplifications and the need for further simplification of IFRS for SMEs, a group that overlaps with the opinions of respondents of the developed countries. Only three answers received from the respondents of emergent countries reflect unreserved agreement. On the other hand, the opinions from the respondents of developed countries are more complex, with a balanced number of answers between absolute negative, positive with reservation and neutral.

For a more clear presentation of the opinions of the respondents from the two groups of countries, Table 1 shows descriptive statistics regarding the four analysis topics and their subdivisions. The assessment of the positive answers in favour of the changes proposed by IFRS for SMEs shows that there is no significant difference between the answers from emergent countries compared to those from the developed countries. The analysis on each topic shows a slight predominance of the agreement given by emergent countries to Q3 and Q9 and a similarity with the opinions from developed countries for the other two questions. These findings confirm the neutrality of opinions as a mean determined for emergent countries.

Ex-post analysis results

Considering the profile of the countries in the IASB survey²⁰, it was observed that 60 countries actually require/allow IFRS for SMEs, and among them 56 are emergent countries (about 35% of this group of countries (see note 3)) and 4 developed countries (12% of this group of countries). Out of the total number of emergent countries, a significant 88% apply unconditionally this standard as all SMEs are permitted to use it and those that do not use IFRS for SMEs must use full IFRS, or, in other cases, IFRS for SMEs is directly required for all SMEs. The rest 12% of countries revised the standard to their own business environment, for example, allowing certain categories of SMEs or all SMEs to choose between IFRS and national Generally Accepted Accounting Principles (GAAPs).

Other statistics are relevant, calculated in relation to the number of emergent countries. Thus, only 10% developed more approachable, simplified national standards for the micro-sized SMEs. Also, only 5% of the emergent countries refer to SMEs which internationalized (for which IFRS for SMEs is more desirable) yet not in the sense of applying the simplified standard, but rather the full IFRS; for example, large companies whose parent or subsidiaries report under full IFRS, major importers or exporters, or companies incorporated outside the country. One country even demands full IFRS for large, as well as medium-sized companies. Moreover, only 10% of the

Table 1. Analysis topics – opinions by countries

Dummy variables (yes = 1)	Emergent countries	Developed countries
	Mean	
Q2 General	0.176	0.185
Q2 Fair value	0.470	0.402
Q2 Financial instruments	0.499	0.443
Q2 Goodwill	0.117	0.237
Q2 Investments in associates and joint ventures	0.205	0.268
Q2 Employee benefits	0.411	0.319
Q3 General	0.294	0.175
Q3 Cash-flow statement	0.205	0.103
Q3 Deferred taxes	0.264	0.175
Q3 Consolidated financial statements	0.176	0.154
Q3 Share-based payment	0.264	0.237
Q6 General	0.264	0.268
Q6 Financial reporting in hyperinflationary economies	0.058	0.123
Q6 Segment reporting	0.088	0.134
Q6 Earnings per share	0.058	0.113
Q6 Insurance contracts	0.029	0.06
Q6 Interim financial reporting	0.088	0.113
Q9 Adequacy of disclosures	0.617	0.587

Note: Standard deviation varies between 0.171 and 0.506.

emergent countries made modifications to IFRS for SMEs as drafted by IASB.

Discussion and conclusion

The research objective was formulated keeping in view of emergent countries, based on arguments which justify the positive impact that a set of high-quality accounting standards, recognized worldwide, could have on the growth of SMEs, correlated with the criticism towards IFRS for emergent environments.

First, the degree of acceptance of IFRS for SMEs in emergent and developed countries was tested. The results indicate neutral views of the respondents from emergent countries, which do not deny clearly, nor confirm significantly, the adequacy of implementing IFRS for SMEs and its simplified version rather than full IFRS. The respondents from developed countries have mixed opinions that range from rejection to full acceptance; in the end leading to the acceptance of the standard by all the countries. The reservations expressed to a certain extent by the respondents, especially from developed countries, denote a certain complexity, due to sophisticated accounting situations and the manner of recognition, valuation and disclosure adopted.

Secondly, the analysis of the current status and details regarding the implementation of the international standard shows how emergent countries were much more open than developed countries to adopt IFRS for SMEs per se. Insignificant changes were made to the standard. The standard was modified in accordance with national rules only to a negligible degree and only for those types

of SMEs considered to be the main beneficiaries, namely large and internationalized SMEs.

This situation can be explained by the mimetic theory²⁹, which for this case study suggests that the respondents (standard setters, preparers of accounts and users) from emergent countries tend to embrace unreservedly concepts or trends supported by majority groups or coming from the developed countries. We refer here to the mimetic process as one of the mechanisms of institutional isomorphism described by DiMaggio and Powell³², which we extrapolate from organizational to institutional level (accounting), relying on the idea that professions are subject to the same mimetic pressures. A more in-depth analysis would reveal political or economic grounds for the decision made by each of the subjects surveyed. Since it was outside the scope of our study to delve deeper into this topic, we can only advance possible economic causes underlying the mimetic behaviour. Starting from the description of this type of attitude by DiMaggio and Powell³², in the pre-issue period of IFRS for SMEs, we can observe some scepticism regarding the opportunity to introduce the standard due to high implementation costs occasioned by the need of consistent preparation (training, discussion forums, field studies), coherent with the claims of public representatives and academics. Another issue is the existence of a less complex economy in these countries and hence a less sophisticated accounting system to reflect it. However, subsequent to the issue of the standard, implementation costs seem to have been reconsidered by the accounting decision-makers in emergent countries and accepted on short term, and thus counterbalanced by the advantages of mimetic behaviour and internalization of the accounting system. This enables the

application of a viable solution with little long-term expenses. To conclude, we suggest that environmental ambiguity and uncertainty, correlated with resource dependency, marked the first reaction of the representatives of emerging countries and further led to the mimetic attitude in the sense of adopting IFRS for SMEs without applying a filter by national standards or imposing some restrictions to the international standard adoption.

Another observation is related to the level of investigation when adopting IFRS for SMEs. Our study examines the rules of adoption and does not attempt to highlight the *de facto* application of IFRS for SMEs. However, there are differences between the accounting rules and practices which can affect the level of IFRS endorsement. Considering the different ways of adopting the international standard by 56 emergent countries at the time of our survey, we noticed that only few jurisdictions did not implement it as drafted, but tailored it to their specific context. From here, referring to the loose coupling concept for which Orton and Weick³⁷ make a useful review of the literature that tackles this issue stemming from organizational theories, we suggest that in the first implementation phase this concept had an intense manifestation. As such, within the same accounting system, deliberate and rational actions regarding the acknowledgement of agents of new accounting concepts and treatments will coexist with old traditions and practices as indeterminate and spontaneous actions. As an effect of this setting, we can see a certain stability, at least in the short run, as proved by Guerreiro *et al.*³⁸ in a case study on IFRS for application of the SMEs, for the few countries which filtered the international standard and made changes and adjustments thereto. For the rest of the countries, the effectiveness of this loosing couple between planning (accounting rules in our case) and implementation (accounting practice), as well as between new and old accounting practices, remains to be examined in the future.

The main limitations of this study are related to the secondary sources used and to a certain degree of subjectivity implied by the ED content analysis. Also, as shown above, it would be beneficial to identify those elements which are loosely coupled in accounting practice (old and new *de facto* actions) of emergent countries, through a series of case studies for national environments or groups of countries which opted for the same type of implementation of IFRS for SMEs. Also, the findings could be used as the basis for further research on the correlation between the growth of SMEs and the expansion of internationalization in emergent environments considering the newly adopted standard.

Notes

1. Small and medium size enterprises (SMEs) are generally defined as non-subsidiary and independent entities. The usual SME classifica-

tion criteria for an entity are quantitative, such as the number of employees, although sometimes revenues or total assets are also used. The IASB standard view the SME as an entity with no public interest that publishes financial statements with general purpose for external users.

2. The database and untabulated statistics can be provided upon request.
3. According to the International Monetary Fund's World Economic Outlook Report, April 2012 and World Bank data, there are 151 developing countries, two other countries not reported by IMF, and another 12 recently reclassified as advanced economies, which in this study have been considered emergent economies, and 34 developed countries.

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