

Premises

Differences amongst Countries is, at the mean time, the most important asset and the most difficult barrier to take over.

At least in Europe, there is a common feature which has been recognised as essential for the economical development: the entrepreneurial textile made of micro, small and medium-sized enterprises (referring to the new definition, which entered into force on 1 January 2005)¹.

Although the IAS Board expressed that these comments should focus on those entities that have a public resound (i.e. with interactive relationships with external environments), it is important to highlight that not considering those micro sized entities, both the *financial* and *credit market* is going to be segmented in three parts. The first made of bigger sized companies and the second of SMEs with a possibility to access to credit, becoming interesting to mergers and acquisitions (then with a chance to grow); the third and last one of micros, to which is certainly precluded the possibility to have a financial independence and to grow in short periods.

The adoption of IAS/IFRS may be a good opportunity to build a positive framework, in which all the *players* know exactly what the rules are, and there is no way to misunderstand them. Mainly for these and for other reasons IAS/IFRS for SMEs should allow even entities to proceed towards a process of cultural development, based on transparency, middle and long term planning, better knowledge of contemporary market and financial phenomenon.

¹ As reported in the article 2 of 2 of the *Annex of Recommendation 2003/361/EC* «the category of *micro, small and medium-sized enterprises (SMEs)* is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro»

Referring to IAS 7

It is important to highlight that most of SMEs' management model - especially in those Regions that belong to the Mediterranean Area and to the Latin Group² - is not based on *middle-long term planning management* schemes, considering *cash payments* as one of the most important and used.

The cash flow statements (reports) many times mirror a situation that has been "rebuilt ex post". Perhaps this is a signal that shows how difficult is to report some kind of operations, considering the context and the company's environment.

Many times, is a Debt Collecting Agency that give the needed and useful information to the Creditor: unfortunately (although the situation is slowly changing) many of these last do not know how to use these data correctly.

Commercial credits and debts (for example in Italy) sometimes are very difficult to evaluate and to report in a statement, especially when there is a legal action, since it is impossible to forecast the time when the legal action will end, and then the value of the collected sum.

In a sense it could be interesting to introduce some forms of *simplified due diligence* (using no more than 3 or 4 criteria) that allow SMEs to understand the real value (the *fair value*) of the credit (or debt).

² Hofstede Classification

Referring to IFRS 2

For what *Share-based Payment* concerns, until nowadays for the reasons already said - and even for a uncertainty of evaluation of the individual SME - it has not been used (at least in Italy).

On the other hand, considering even some other national and EU Reform Laws, a *Share-based payment* could be used in Medium Sized Entities in those periods of crisis, in order to reduce the need of cash. For this reason the use of a form of *simplified due diligence* may allow SMEs to have a new channel to access to credit.

Moreover - at least in Europe, but even in other Countries - this solutions will not face any kind of risk of exchange rate (thanking to the adoption of Euro and US Dollar in trans-national tradings).

Referring to IAS 17

Sale and leaseback is a kind of transaction that is becoming very common even amongst smaller sized entities: this is mainly due to financial needs.

Following the logic of IAS 17 (from parag. 58 to 66) neither loss or profit should be recognised immediately, in order to let SMEs access easily to credit, using assets already owned and reducing the incidence of taxation.

In this way market will reach two aims: an easier channel to access to credit, using internal resources and re-evaluating them; in SMEs' financial statements will be reported information at fair value (calculated and updated mainly by Lessees).

Moreover - even in Italy - many Leasing Company are beginning to stipulate contracts with SMEs on intangible assets (brands, trade marks, etc.), using it as a possible financial channel where to obtain credit.

While for Bigger Sized Companies, this could be considered as a transfer of the ownership, and then another way to make profits, for SMEs this contract can be considered only the first step of a developing entrepreneurial and financial culture.

It is not possible to forecast the quantity or the quality of these kind of operations in the future, but whether SMEs will approach more to this financial instrument (Leasing), many problems and difficulties (related to the lower knowledge and entrepreneurial and financial culture) may be overtaken.

Referring to I.A.S. 27

Due to Globalisation³ many SMEs were forced (and even nowadays) to begin a process of de-localisation in other Countries in order to keep and maintain their competitiveness and then their market shares.

For example many Italian Companies - classified as Small, referring to that time current standard - during 1980's and 1990's moved to Eastern Europe Countries, in order to cut productive costs (especially Human Resources), with the final result that many of them became (or were being considered) *Big Sized*.

This is was due both to the need (or forced) to create locally a new organised company⁴, usually controlled by the Italian parent: obviously the mix of lower costs, governmental de tax policies, and good entrepreneurial and commercial capabilities allowed and led the new group to reach interesting and important results in terms of revenues and employees, that changed in a short time the condition and size of the (previous) SME.

The same circumstance is now happening with those and other Countries (for example Ireland, especially for intangibles assets and activities).

The examples reported show how a SME is sometimes in the condition of adopting I.A.S./I.F.R.S.:

- operating and trading in different Countries and Markets, even though this does not mean being an international or multinational Organisation;
- having control of other entities or even the management of specific programs or projects.

In order to clarify the position (that does not agree with the proposed affirmation that "*SMEs generally do not have subsidiaries*") many SMEs are involved in R&D programmes financed by the European Commission⁵ in which one of the most important feature of the proposals is the constitution of a partnership between different subjects (entities) from different countries (EU and no-EU).

³ the process of de-nationalization of markets, politics and legal systems, with the consequences of the political and economic restructuring on local economies, human welfare and environment

⁴ this choice is many times related to the local legislation

⁵ referring for example to the several Research Frameworks

More over with the application of *Basel 2 (The New Basel Capital Accord)* many SMEs - in order to continue obtaining credits by Banks and financial intermediaries - are going to take part (even in the constitution) of *Mutual Guarantee Societies*⁶. See also comments and considerations on I.A.S. 32 of the present paper.

In order to keep transparency and to allow an objective evaluation of the financial position of the individual SME, it should be important to:

- identify detailed criteria that put the individual or the group of entities in the condition of direct (ownership of subsidiary that allow to vote ad to decide) or indirect (trusts, agreements amongst different shareholders and investors, etc.) govern, and then in the need of presentation of consolidated financial statements;
- identify a single data (or information) that let the SMEs not to present a *consolidated financial statements*, but as well to report those information (that may influence profit or loss of the investor/parent) needed to better understand the global position of the entity itself (parent).

Since many SMEs will adopt (due to their needs) IAS/IFRS in order to better access to credit market, all the investments in controlled entities should be accounted for in accordance with I.A.S. 39.

As long as to avoid different evaluation (some times related to the single entity's needs) it should be estimated by a third part on behalf of the controlled company, giving a range of the real value (in accordance with IAS 39). The differences of the range should be exposed and justified in the statement, referring to particular conditions (a sort of *due-diligence*).

⁶ Especially Micro, Small and Medium companies (after acquiring some shares) ask them for a guarantee, in order to obtain credit both by Banks and by Investors (institutional or private).

Referring to IAS 32

In the last decades in Europe (especially on the Continent of Europe) have born and developed the Mutual Guarantee Societies⁷, which have been encouraged even by the policy of the European Union.

Especially Micro, Small and Medium companies (after acquiring some shares) ask them for a guarantee, in order to obtain credit both by Banks and by Investors (institutional or private).

We should make two different considerations.

First of all, since these Organisations (entities) work and live independently from the SMEs, it is very difficult to measure the risk to which the MGS is exposed, and then to update this data into the Financial Report of a SMEs. This for two orders of reasons: each MGS⁸ should supply SMEs with a number of data and information on their financial position (even on their derivatives), in time to let the SMEs to build a credible report. If this time is too long, the value of this information is very low and then is useless.

Moreover since this method of guarantee is very spread amongst SMEs, and these do not have a deep financial education, it can be very difficult for them to use the methods and principles described in IAS 32 (from parag. 86). This is supported by the forecast that with Basel II, MGS will have a sudden increase in terms of quantity and in terms of guarantees lent: on the contrary many of them (those which will not follow correct financial and credit risk management policies) will see their value considerably reduced.

The second consideration is that using this techniques, third parts (like for examples Banks or investors) might find difficulties in forecasting the value of their credits or debts, in case of financial defaults.

⁷ A Mutual Guarantee Society is a group of business who use their collective strength to obtain the best possible terms for business borrowing and help one another to ensure their survival and prosperity. Mutual Guarantee Societies are very common especially on the Continent of Europe and their development is encouraged even by the European Union. M. G. S. revolve around a fund of money that is used to guarantee loans from mainstream organisations. In this way businesses with ideas or the need to expand are helped to do so even though they do not have a sufficient track record, credit rating, or asset base to access these funds on their own.

⁸ Mutual Guarantee Society

So, a possible solution is to make a set of guidelines (containing only those really needed information) that a SME need in reporting its position.

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