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STATEMENT OF

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Benefits of High Quality Financial Reporting

Let me begin by commenting on the benefits of high quality financial reporting by small and medium-sized entities (SMEs). I will then make some related observations about listed companies and micro sized entities.

Public interest in SME financial reporting

In most countries somewhere between 40% and 80% of SMEs have bank loans, which means there is an outside capital provider who needs financial statements. And this includes micro-sized SMEs. In addition to banks, there are other lenders, vendors, customers, rating agencies, venture capitalists, and outside investors all of whom use the financial statements of SMEs to make credit, lending, and investment decisions. They want high quality, comparable information, tailored to their needs. In short, there is a public interest in sound and transparent financial reporting by small companies.

That is why, in most countries in the world, the law or regulation requires all or most SMEs to publish general purpose financial statements (GPFS)—and, in many jurisdictions, to have them audited.

GPFS are aimed at financial statement users who are external to the company. GPFS present financial position, results of operations, cash flows, and changes in equity. An independent auditor is able to express an opinion on whether those GPFS constitute a fair presentation or true and fair view.

It is not the IASB or the accounting profession who impose financial reporting obligations in jurisdictions around the world—it is legislators and regulators acting in the public interest.

The *IFRS for SMEs*

In late 2003—in response to an overwhelming demand from regulators, standard-setters, small businesses, and auditors in both developed and emerging economies across the globe—the IASB decided to develop a separate standard for smaller companies. Six years later (in July 2009) the *IFRS for SMEs* was issued. It is 230 pages long (full IFRSs are over 3,000 pages). Organised by topic. With many simplifications and disclosure reductions compared to full IFRSs.

Why a global SME accounting standard?

Why was there such demand for a global SME accounting standard in addition to full IFRSs? There are many good reasons:

1. An IASB standard tailored to the needs of those who lend and extend credit to SMEs improves the quality of financial reporting by small companies and opens doors for them to obtain capital. Users of SMEs' financial statements say they are mainly interested in information about short-term cash flows, liquidity, and solvency. They do not need the kinds of information that long-term equity investors in public capital markets look for, or the breadth and volume of disclosures that full IFRSs require.

2. SMEs often say they find full IFRSs burdensome and costly to implement because full IFRSs are designed to meet the needs of public capital markets. SMEs often make the same complaint about local standards that have been converged with full IFRSs.

3. Unfortunately, in many jurisdictions, the quality of implementation of full IFRSs (or converged local equivalents) needs improvement. That is particularly true in the case of small companies and developing countries. Don't just take my word for it. Read some of the ROSC Reports on accounting prepared by the World Bank for nearly 100 countries. It is much easier for SMEs to comply with a standard designed for SMEs.

4. Locally developed SME standards often have serious shortcomings:

   a. They don't give users the information they need, such as a cash flow statement and full disclosure of obligations;

   b. They are not readily understood by lenders and other capital providers, particularly across borders;

   c. They have limited support (eg textbooks and software); and

   d. Sometimes they are weakly enforced.

5. A global standard makes financial reporting by SMEs comparable across borders and within a country. To use the European Union as an example, today the 27 member states have roughly 60 different local GAAPs for unlisted companies—despite their objective of a 'common market'.

Capital providers want transparency. They know how to assess and balance both good news and bad news. What they don't want (and impose a price for) is uncertainty.

Similar benefits for public capital markets

High quality global accounting standards are equally important for public capital markets, in fact even more so because individual investors do not have the same kind of power that a bank lender or potential creditor might have to demand the information they need.

Over 120 countries agree, because they have adopted full IFRSs or equivalents for public companies.

Good accounting standards—carefully applied—result in reported financial information that is more relevant, reliable, understandable, and comparable.

'Carefully applied' means that there is an infrastructure in place in a jurisdiction to:

- train people in the standards,
- offer implementation guidance in light of local laws and regulations,
- enforce compliance, and
- follow up on perceived implementation shortcomings.

There is a 'payback' for using a rigorous global financial reporting standard

The number one payback is improved access to capital. Smaller companies consistently complain that 'my business is successful and growing, yet it is very hard to get a bank loan or other credit'. The lenders, on the other hand, respond 'we do not understand or have confidence in the reported financial figures'. Improved financial reporting is aimed at helping SMEs get loans and credit and/or helping to reduce the price they have to pay for that capital.

Where is the *IFRS for SMEs* being used?

For SMEs, most jurisdictions are moving to the *IFRS for SMEs*. Today, just three years after it was issued, over 80 jurisdictions have adopted it. Very few of those have made any amendments to its contents whatsoever. Most simply allow or require all SMEs to use it. Of course, a company following an amended standard cannot assert compliance with the *IFRS for SMEs*—thereby losing a principal benefit of following a globally recognised standard.

To use Brazil as an illustration, starting in 2010 all 6 million Brazilian SMEs have been required to use the *IFRS for SMEs*. That includes all micro sized SMEs. The IASB conducted a three-day training workshop that included 700 participants in person and another 17,000 live via broadcast throughout Brazil. The Brazilian professional accountancy bodies then organised dozens of training workshops around the country. The result is that the transition went very smoothly. Many of Brazil's neighbours, including Argentina, Chile, Peru and virtually all of Central America and the Caribbean, also have adopted the *IFRS for SMEs*. There are similar stories in Africa, Asia, and increasingly in Eastern Europe and the Middle East as well.

Suitability for micro-sized entities

The Board said—and it is my personal view as well—that the *IFRS for SMEs* is suitable for any entity without public accountability (regardless of size) that is required by law or regulation, or chooses, to prepare general purpose financial statements (GPFS). GPFS provide information to lenders, creditors, investors, and other financial statement users who are external to the company. GPFS help bring about the efficient allocation and pricing of capital in an economy.

Some micro-sized companies may look at the 230-page *IFRS for SMEs* and find it daunting. Actually, for most micros, a good number of the sections of the standard may have no relevance at all. And even in those sections that do have relevance, some of the specific principles or topics may not affect most micros. Many of the 80 jurisdictions that have adopted the *IFRS for SMEs* are developing countries, with mostly micro-sized entities.

Even so, I am happy to report that the IASB is currently exploring ways to 'repackage' the *IFRS for SMEs* into a much smaller document to meet the needs of micros.

Conclusion

General purpose financial statements are used in making financing decisions by lenders, vendors, customers, venture capitalists, and other outside capital providers, as well as by rating agencies, governments, and others external to the entity. That is why there is a public interest in sound and transparent financial reporting. And that is why there is a need for a strong infrastructure to support rigorous implementation of good global accounting standards.

And there is a payback to the company—improved access to capital.

If capital providers understand and have confidence in a company's financial figures, its ability to obtain the capital it needs improves, its cost of capital is reduced, and the company prospers. Ultimately, this will lead to overall benefits for the economy in which the company operates.