

**The feasibility of the statement of generally accepted accounting  
practice for small and medium enterprises**

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<sup>5</sup>And the LORD came down to see the city and the tower, which the children of men builded. <sup>6</sup>And the LORD said, Behold, the people is one, and they have all one language; and this they begin to do: and now nothing will be restrained from them, which they have imagined to do. <sup>7</sup>Go to, let us go down, and there confound their language, that they may not understand one another's speech. <sup>8</sup>So the LORD scattered them abroad from thence upon the face of all the earth: and they left off to build the city. <sup>9</sup>Therefore is the name of it called Babel; because the LORD did there confound the language of all the earth: and from thence did the LORD scatter them abroad upon the face of all the earth.”

(Genesis 11:5-9 King James Version)

## **Introductory remarks**

The reader is reminded of the following:

- The thesis is presented in the article format in accordance with the policies of the faculty of Economical and Management Sciences' (North-West University) WorkWell Research Unit.
- The thesis consists of a total of five scientific journal articles.
- Each of the articles in the thesis complies with the individual writing style requirements as per the journal to which the applicable article was submitted.

## Acknowledgements

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## **Thesis summary**

Topic: The feasibility of the Statement of Generally Accepted Accounting Practice (GAAP) for Small and Medium Entities (SMEs).

Key terms: Accounting values, accounting practices, collectivism, conservatism, cultural dimensions, environmental factors, femininity, flexibility, illustrative financial statements, individualism, International Accounting Standards Board, International Financial Reporting Standards, masculinity, optimism, power distance, professionalism, secrecy, small and medium entities, statutory control, transparency, uncertainty avoidance, uniformity.

Governments are becoming increasingly aware of SMEs as economical role players. As a result many initiatives were introduced to address the unique challenges of the SME sector. One of these initiatives was the introduction of a global accounting framework for SMEs by the International Accounting Standards Board entitled the IFRS for SMEs. South Africa became the first country to formally adopt the contents thereof as the Statement of GAAP for SMEs.

The adoption of a formal accounting framework by SMEs is however challenged by, amongst other factors, the informal nature of SMEs, limited global focus, the involvement of owner-managers and different classifications of SMEs worldwide. Owing to these unique attributes it is possible that SMEs have alternative informational needs and as a result the impact of environmental factors on the adoption of the Statement of GAAP for SMEs was considered.

Culture is considered the most important environmental factor affecting the accounting environment. The Value Survey Model of Hofstede was utilised to determine cultural dimensions of accounting students ( $n = 301$ ) in South Africa and the United Kingdom (UK). The cultural dimensions were extended to the accounting values of Gray after which a distinct set of accounting values was identified for i) the adoption of formal, global and prescriptive accounting standards, ii) based on principles iii) by an informal SME sector. The results also revealed distinct cultural differences within South Africa as well as between South Africa and the UK.

Thereafter the contents of the Statement of GAAP for SMEs/IFRS for SMEs were evaluated against reporting practices of the SME sector in South Africa. Firstly, an assessment of the contents was conducted amongst SME accountants ( $n = 157$ ) using a five-point Likert-type scale.

Secondly, financial statements compiled by the SME sector in South Africa were analysed to determine the relevance of the contents of the illustrative financial statements contained in the Statement of GAAP for SMEs. The analysis entailed a consolidation of a sample of SME financial statements from South Africa ( $n = 100$ ).

The study revealed that the accounting environment of the SME sector is affected by a wide range of environmental and related factors. These factors were summarised and discussed and recommendations for future research were made.

## **Proefskrif opsomming**

Titel: Die lewensvatbaarheid van die Standpunt oor Algemeen Aanvaarde Rekeningkundige Praktyk (AARP) vir Klein en Medium Entiteite.

Sleuteltermes: Rekeningkundige waardes, rekeningkundige praktyke, kollektiwisme, konservatisme, kultuurdimensies, omgewingsfaktore, vroulikheid, fleksibiliteit, illustrerende finansiële state, individualisme, Internasionale Raad vir Rekeningkundige Standaarde, Internasionale Finansiële Verslagdoeningstandaarde, manlikheid, optimisme, mags-afstand, professionalisme, geheimhouding, klein en medium entiteite, statutêre beheer, deursigtigheid, onsekerheids-vermyding, eenvormigheid.

Regerings word al meer bewus van die ekonomiese rol wat klein en medium entiteite vertolk. Dit het gevolglik aanleiding gegee tot 'n aantal inisiatiewe om die unieke uitdagings van die klein en medium besigheidsektor aan te spreek. 'n Onlangse inisiatief in die verband was die aankondiging van 'n globale rekeningkundige raamwerk deur die Internasionale Raad vir Rekeningkundige Standaarde getiteld "IFRS for SMEs". Suid Afrika was die eerste land wat die inhoud daarvan as die Standpunt oor AARP vir Klein en Medium Entiteite aangeneem het.

Die aanneming van 'n formele rekeningkundige raamwerk deur klein en medium entiteite word egter deur 'n aantal uitdagings gekonfronteer, onder andere die informele aard van klein en medium entiteite, 'n beperkte globale fokus, die betrokkenheid van eienaar-bestuurders asook onkonsekwente klassifikasies van klein en medium entiteite deur verskillende lande. Op grond van hierdie unieke eienskappe bestaan die moontlikheid dat klein en medium entiteite alternatiewe inligtingsbehoefte het en gevolglik is die invloed van omgewingsfaktore ten opsigte van die implementering van die Standpunt oor AARP vir Klein en Medium Entiteite oorweeg.

Kultuur word beskou as die belangrikste omgewingsfaktor wat die rekeningkundige omgewing beïnvloed. Hofstede se Waarde Opname Model is gebruik om kultuurdimensies ten opsigte van rekeningkundige studente ( $n = 301$ ) in Suid-Afrika en die Verenigde Koninkryk (VK). Die kultuurdimensies is verder verwerk in Gray se rekeningkundige waardes waarna onderskeibare rekeningkundige waardes geïdentifiseer is vir i) die aanneming van formele, globale en

voorskriftelike rekeningkundige standaarde, ii) gebaseer op beginsels iii) deur 'n informele klein en medium besigheidsektor. Die resultate het ook onderskeibare kultuurverskille in die Suid-Afrikaanse konteks sowel as tussen Suid-Afrika en die VK aan die lig gebring.

Die inhoud van die Standpunt oor AARP vir Klein en Medium Entiteite is daarna geëvalueer aan die hand van verslagdoeningspraktyke deur die klein en medium sektor in Suid-Afrika. 'n Assessering van die inhoud is eerstens uitgevoer onder klein en medium rekenmeesters ( $n = 157$ ) met behulp van 'n vyf-punt Likert-tipe skaal. In die tweede plek is 'n aantal finansiële state van klein en medium besighede ontleed om die toepaslikheid van die inhoud van die illustrerende finansiële state van die Standpunt oor AARP vir Klein en Medium Entiteite te bepaal. Die ontleding het 'n konsolidasie van finansiële state deur klein en medium entiteite in Suid-Afrika behels ( $n = 100$ ).

Daar is bevind dat 'n wye reeks omgewings en verwante faktore die rekeningkundige omgewing van klein en medium besighede affekteer. Hierdie faktore is opgesom en aanbevelings ten opsigte van verdere navorsing is gemaak.

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## List of abbreviations

<i>ACCA:</i>	<i>Association of Chartered Certified Accountants</i>
<i>AICPA:</i>	<i>American Institute of Certified Public Accountants</i>
<i>APB:</i>	<i>Accounting Practice's Board</i>
<i>CCS:</i>	<i>Competition Commission Singapore</i>
<i>CESR:</i>	<i>Committee of European Securities Regulators</i>
<i>DMU:</i>	<i>De Montfort University</i>
<i>DNT:</i>	<i>Department: National Treasury</i>
<i>DoJ:</i>	<i>Department of Justice</i>
<i>DTI:</i>	<i>Department of Trade and Industry</i>
<i>EACB:</i>	<i>European Association of Co-operative Banks</i>
<i>EC:</i>	<i>European Commission</i>
<i>ED:</i>	<i>Exposure draft</i>
<i>EU:</i>	<i>European Union</i>
<i>FASB:</i>	<i>Financial Accounting Standards Board</i>
<i>FEI:</i>	<i>Financial Executives International</i>
<i>FERF:</i>	<i>Financial Executives Research Foundation</i>
<i>GASB:</i>	<i>German Accounting Standards Board</i>
<i>HDI:</i>	<i>Human Development Index</i>
<i>HKICPA:</i>	<i>Hong Kong Institute of Certified Public Accountants</i>
<i>IASB:</i>	<i>International Accounting Standards Board</i>
<i>IASC:</i>	<i>International Accounting Standards Committee</i>
<i>ICAS:</i>	<i>The Institute of Chartered Accountants of Scotland</i>
<i>IDV:</i>	<i>Individualism</i>

<b>IFRS:</b>	<b><i>International Financial Reporting Standards</i></b>
<b>INECE:</b>	<b><i>International Network for Environmental Compliance and Enforcement</i></b>
<b>MAS:</b>	<b><i>Masculinity</i></b>
<b>MFK:</b>	<b><i>Mafikeng Campus</i></b>
<b>OECD:</b>	<b><i>Organisation for Economic Co-operation and Development</i></b>
<b>PDI:</b>	<b><i>Power Distance</i></b>
<b>PTC:</b>	<b><i>Potchefstroom Campus</i></b>
<b>RObj:</b>	<b><i>Research Objective</i></b>
<b>SA GAAP:</b>	<b><i>South African Generally Accepted Accounting Practice</i></b>
<b>SAICA:</b>	<b><i>South African Institute of Chartered Accountants</i></b>
<b>SARS:</b>	<b><i>South African Revenue Service</i></b>
<b>SEC:</b>	<b><i>Securities Exchange Commission</i></b>
<b>SMEs:</b>	<b><i>Small and medium entities/enterprises</i></b>
<b>SMMEs:</b>	<b><i>Small, medium and micro-enterprises</i></b>
<b>UAI:</b>	<b><i>Uncertainty avoidance</i></b>
<b>UK:</b>	<b><i>United Kingdom</i></b>
<b>US GAAP:</b>	<b><i>US Generally Accepted Accounting Principles</i></b>
<b>US:</b>	<b><i>United States</i></b>
<b>VAT:</b>	<b><i>Value-added tax</i></b>
<b>VSM:</b>	<b><i>Value Survey Model</i></b>

## **CHAPTER 1 - Introduction**

### **1. Background**

On a global scale, the importance of small and medium sized entities as a role player in the economy cannot be overlooked. For example, in the United Kingdom (UK) the annual turnover by the small business sector amounts to more than £1,000 billion, or around 45% of the private sector economic activity (Johnston & Loader, 2003:273). Furthermore, at the start of 2001 small businesses accounted for 99% of all businesses in the UK (Small Business Service, 2002:1). In recognition of the importance of the small business sector the UK Government introduced the Small Business Service in April 2000 to actively promote the growth of small businesses (Johnston & Loader, 2003:273). According to Mulhern (1996:77), the European Union adopted an overall policy position towards the small medium entity (SME) sector, which includes the following:

- The development of more open and competitive market structures;
- Specific measures to encourage the creation and development of small firms, such as the removal of restrictive legal and administrative regulations, as well as simplified SME accounting procedures; and
- Measures to assist SMEs building partnerships and business alliances.

A key constraint identified for SMEs in the UK was the accounting function. Randall and Horsman (1997:42) found that an inadequate financial accounting function, as provided by accountants, bank managers and computer accounting packages, was one of the major reasons for failed businesses in this sector. In support of this observation Peacock (2000:21) found that there is a significant relationship between business failure and inadequate accounting records for Australian SMEs.

In the South African context, small, medium and micro-entities (SMMEs) were identified as an important vehicle to address the challenges of job creation, economic growth and equity. The South African Government identified the development and stimulation of SMMEs as a priority

and an important engine to drive sustainable and equitable growth (White paper, 1995:3). In addition, the promotion of this sector was one of the critical social and economic development areas identified by the Reconstruction and Development Program (White paper, 1995:4). Locally, SMMEs include close to a million enterprises that are highly diversified and absorb approximately a quarter of the labour force of 15 million people in South Africa (White paper, 1995:5).

The fact that the sector has been neglected was acknowledged in 1995 by the Government of National Unity, which provided support for SMMEs and encouraged further research in this field (White paper, 1995:14; DNT, 2001:27). As a result various constraints facing SMMEs were identified, including the following:

- The legal and regulatory environment confronting SMMEs;
- Access to markets, finance and business premises;
- Acquisition of skills and managerial expertise;
- Access to appropriate technology;
- Quality of the business infrastructure in poverty areas; and
- Limited black owned or controlled small entities due to Apartheid.

Moreover, the lack of 'formality' in terms of business licenses, value-added tax (VAT) registration, formal business premises, operating permits and accounting procedures, was listed as a key characteristic of SMMEs (White Paper, 1995:11).

Over the last decade the SME sector remained a priority for the South African government. This led to the publication of the Review of Ten Years of Small Business Support in South Africa (1994 to 2004) and Reviews of Small Business in South Africa (released annually since 1995), as well as a number of support initiatives, including:

- The Small Enterprise Development Agency;
- The National Small Business Act of 1996;
- The Ntsika Enterprise Promotion Agency;

- The Centre for Small Business Promotion;
- Khula Enterprise Finance; and
- Various national/official initiatives to promote SMEs.

(DTI, 2010:3; DNT, 2001:14)

In addition, government adopted a strategy to reduce small enterprise regulatory constraints (DTI, 2010:4) and to promote an adequate small business support network between government departments (including the Department of Trade and Industry (the DTI), the Tourism Enterprise Programme of the Department of Environment and Tourism, the Local Economic Development programmes of the Department of Provincial and Local Government, and the New Venture Creation Learnerships of the Department of Labour (Philip & Hassen, 2008:11)) and non-governmental institutions (including banks, accountants, the legal profession, suppliers, customers, labour and trade associations (DTI, 2010:32)).

## **2. Motivation**

Over the last 15 years the focus of accounting research was mainly on the development of international accounting standards and the adoption of these standards by large industrialised countries (Zeghal & Mhedhbi, 2006:374). The question remains as to what extent proposed accounting and disclosure requirements are assessed against the readiness and current practices of accountants.

It was recently announced that the new proposed financial reporting framework for SMEs is expected to be easier to grasp and apply, and that it would provide relief from many of the historical disclosure requirements (Temkin, 2007:1). In Europe however, International Financial Reporting Standards (IFRS) for SMEs was criticised as still being too complicated for SMEs (Mackintosh, 2008:83). South Africa was the first country to adopt the international exposure draft on IFRS for SMEs as a formal accounting statement (SAICA, 2007:1). The following factors, however, might have an impact on the application of an international set of accounting rules in the South African context:

- Uncertainty as to whether such reporting standards would be enforceable to SMEs (Vorster, Koornhof, Oberholster, Koppeschaar, Coetzee, Janse van Rensburg & Binnekade, 2007:5).
- South African SMEs are not necessarily exposed to environments and conditions applicable to other parts of the world. In particular, research has indicated that different environmental influences prevented unified and global accounting practices (Askary, 2006:102).

### **3. Statement of the problem and research objectives**

It cannot be denied that the South African SME sector is an important contributor to the overall economy. However, one of the major characteristics/constraints identified in respect of the SME sector is a lack of proper accounting systems and adherence to a comprehensive list of accounting requirements (White paper, 1995:7). A key objective of the Statement of GAAP for SMEs is to develop a set of high quality, understandable and enforceable global standards for this sector (SAICA, 2007:4). Therefore, the primary research question can thus be formulated as follows:

*P1: To what extent will the Statement of GAAP for SMEs be viable in the South African context?*

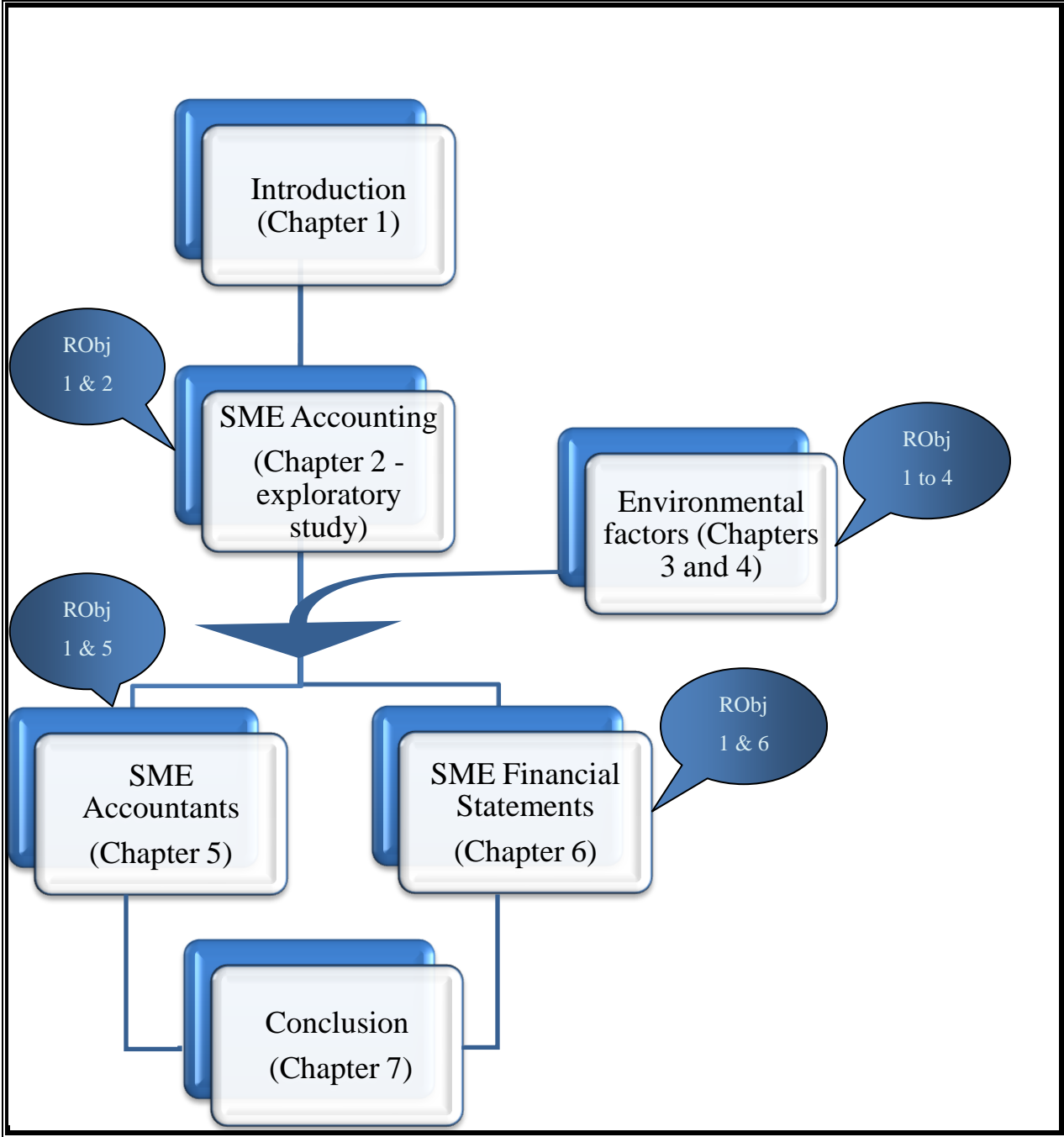
Based on the above problem statement, the following research objectives (RObj) have been formulated:

1. To consider the implications when global accounting standards are adopted by the SME sector;
2. To consider the unique nature and attributes of SMEs;
3. To identify differences between large/listed entities and SMEs;
4. To identify relevant environmental factors influencing the SME accounting environment;

5. To evaluate the relevance of the contents of the Statement of GAAP for SMEs against the practices of SME accountants as the preparers of financial statements;
6. To determine the extent to which the proposed contents of the newly adopted Statement of GAAP for SMEs are included in the financial statements compiled by the South African SMEs.

The detailed research objectives will then be addressed in research articles 1 to 5 which comprise the bulk of the thesis. Figure 1 below illustrates the content of the individual articles in attaining the objectives and addressing the research question.

Figure 1 – Research objectives (RObj) and chapter layout



#### **4. Hypothesis**

A crucial step in the development of new legislation is the evaluation of the various legislative proposals and consultation with the stakeholders (DoJ, 2004:1). If such legislation is enacted without proper evaluation and consultation the proposed legislation might not meet its objectives. Likewise, if SME accounting and financial reporting standards are introduced without a proper evaluation and consultation, it is likely that its ultimate objectives will not be achieved. Based hereupon, the following research hypothesis, on which this overall study is based, can be formulated:

*H1: The application and enforcement of the Statement of GAAP for SMEs will not be feasible in the South African context.*

#### **5. Research philosophy**

In order to adequately address the research question the research philosophy should be properly defined in order to select the most appropriate research approach. There are two types of research philosophies that will be considered, namely epistemological philosophy and ontological philosophy. Epistemology is the study of knowledge or beliefs and refers to the ways to acquire the knowledge. Epistemological philosophy is further divided in two parts: positivism and interpretivism. Positivism is a study of social reality or how the social world can be analysed. Interpretivism, on the other hand, relates to elements such as values, norms and subjective positioning of the researcher and the research community in an attempt to interpret reality (Bauer, Festner, Gruber, Harteis & Heid, 2004).

In contrast to epistemology, ontological philosophy refers to the subject of existence. The ontological assumption is divided into objectivism and constructionism. Objectivism holds that reality exists independent of consciousness and that human beings have direct contact with reality through their perceptions. In contrast, constructionism accepts that social phenomena can be accomplished by social actions. Constructivists maintain that scientific knowledge is

constructed by scientists and not discovered from the world (Sequeira, 2010). Within constructionist thought, a social construction is a concept or practice that is the construct of a particular group (Hazelrigg, 1986).

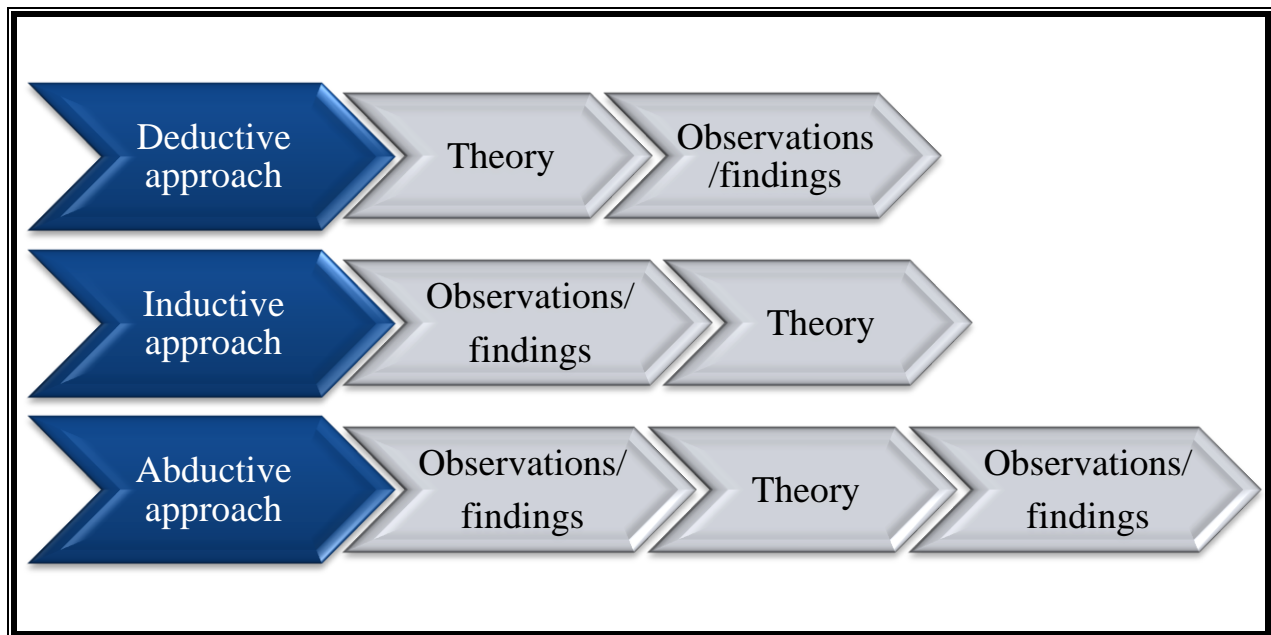
Firstly, due to the fact that the study will consider the possible impact of the IFRS for SMEs on South African SMEs and the related norms and values of SME role players, the interpretivist's position will be adopted for the epistemological assumption.

Secondly, with regards to the ontological assumption a significant amount of emphasis will be placed on the central role of the accountant in society. As a result of this social construct and the fact that accounting is practised by people for people, constructionism will be considered important.

## **6. Research approach**

The extent to which this study will address the research question is also dependant on an appropriate and effective research approach. According to Morgan (2007:71) research approaches can be segregated into three different types: inductive, deductive and abductive approaches. With a deductive approach a conceptual and theoretical structure is developed and then tested by empirical observations (Easton, 2002). According to this approach the direction of the research is from a general law to a specific case and data is collected to test the theories (Andreewsky & Bourcier, 2000; Taylor, Fisher & Dufresne, 2002). The inductive approach is normally from a particular to a general approach and data is collected to generate theories. In this approach, theory is developed from observations in order to generate theoretical conclusions (Kovacs & Spens, 2005:137). Finally, abduction could be seen as a combination of both the deductive and inductive approaches. According to this approach there is a back and forth movement between the inductive and deductive approaches - first converting observations into theories and then assessing theories through action (Morgan, 2007:71). Figure 2 below illustrates the different types of approaches when conducting research:

**Figure 2 – Research approaches**



(Source: Own research)

With reference to the objectives and chapter layout in figure 1 initial observations in connection with SME disclosure practises in the South African environment will firstly be considered (chapter 2). Thereafter the theoretical basis of the IFRS for SMEs will be evaluated, including factors influencing the adoption of a global accounting framework by the SME sector (chapters 3 and 4). Finally the study will consider more detailed observations from SME practitioners and SME financial statements in connection with the feasibility of the IFRS for SMEs in the South African environment (chapters 5 and 6). The research will therefore include not only an analysis of empirical findings which will be tested against the theoretical framework, but also an evaluation of factors affecting the theoretical foundation of the IFRS for SMEs. For this reason an abductive approach will be adopted in this study.

## **7. Research method**

The research will encompass both a literature and empirical study. The literature study will be conducted in connection with the development and current status of accounting reporting standards. The literature study will also form the foundation for the empirical study, which will focus on the practical application of accounting reporting standards by the SME sector in South Africa.

The empirical study will commence with an assessment of the current status of accounting for SMEs. In support of the findings of Collis and Jarvis (2002:108) with regards to the importance and role of the external accountant for SMEs, the focus will be on the accounting environment and background of SME accountants.

The accounting environment encompasses a wide variety of functions and role players. Willingham (1964:545) identified four dimensions of roles as the relevant determinants of accountable interaction namely i) task or activity, ii) authority, iii) deference of prestige and iv) affect of emotion. Schwarze (2008:148) furthermore identified the role players in the greater accounting community as: i) accounting professionals involved in commerce and public practice, ii) accounting academics, iii) accounting trainees and iv) accounting students still at university. In addition Jacob and Madu (2004:356-357) identified accounting regulators, including the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB), as major role players in bringing the world closer to a universal accounting language. As a result the accounting function can be classified in the following phases:

**Figure 3 - Accounting functions and accounting role players**



(Source: Own research)

Seen against the above accounting functions the earlier defined objectives will be addressed as follows:

- Firstly, the processes followed in developing the Statement of GAAP for SMEs/IFRS for SMEs will be considered.
- Secondly, environmental factors affecting accountants from diverse backgrounds will be considered. The Value Survey Model (1994), as developed by Hofstede, will be utilised in this regard.
- Thirdly the contents of the Statement of GAAP for SMEs will be evaluated against the current practices of SME accountants in South Africa as well as experience gained by accounting trainees in the SME sector. Questionnaires, addressed to SME accountants, will be utilised in this phase of the empirical study.
- Finally, the contents of a sample of SME financial statements will be compared and assessed against the illustrative financial statements included in the Statement of GAAP for SMEs.

## **8. Chapter layout**

The research will be concluded in an article-based thesis and is divided into the following seven chapters.

### *8.1. Chapter 1 – Introduction*

The key objective of this chapter is to formulate a problem statement, the related research method, to serve as an introduction to the study and to set the foundation for the empirical study.

### *8.2. Chapter 2 – The impact of the Statement of GAAP for SMEs in South Africa*

The second chapter (research article 1) will focus on the background, perceptions and mind-set of SME accountants relating to compliance with accounting standards. The possibility that the preparers of SME financial statements have different reporting requirements than the proposed accounting standards will also be investigated. The chapter will comprise an exploratory study in connection with the involvement of SME accountants in the development of the Statement of GAAP for SMEs, as well as a preliminary evaluation of the contents of the Statement of GAAP for SMEs against the perceptions of SME accountants and the contents of a sample of SME financial statements. The results will provide guidance in connection with specific focus areas pertaining to the feasibility of the Statement of GAAP for SMEs in South Africa.

### *8.3. Chapter 3 – Understanding alternative perceptions of accounting practices and standards: An examination of cross-country cultural difference in accounting students cultural backgrounds of the accounting environment*

The third chapter (research article 2) will consider cultural backgrounds and its impact on the accounting environment. Comparative consideration will be performed on accounting students with dissimilar cultural backgrounds. In support of the findings by Askary (2006:102) cultural differences of accounting students within South Africa will be considered and evaluated. In addition cultural considerations of accounting students from South Africa will be compared to accounting students in the United Kingdom. The main focus of the study will be to evaluate the

impact of cultural differences on the adoption and implementation of a single global set of accounting standards.

#### *8.4. Chapter 4 – Cultural considerations and the implementation of IFRS – An SME focus*

The fourth chapter (research article 3) will consider the differences in cultural backgrounds of the accounting students included in the preceding chapter and its impact on the SME environment. The unique and distinct nature of SMEs will be considered and compared to publicly listed entities with a diverse range of international investors. As a result the relevant attributes considered to be a prerequisite for the adoption of a single global set of accounting standards will be considered and compared to the unique nature of SMEs and the environment in which they operate.

#### *8.5. Chapter 5 – A critical analysis of the contents of the Statement of GAAP for SMEs (IFRS for SMEs) - A South African perspective*

The fifth chapter (research article 4) will focus on the contents of the Statement of GAAP for SMEs/IFRS for SMEs. Firstly the procedures and processes followed by the International Accounting Standards Board in developing and deciding on the contents of the IFRS for SMEs will be evaluated. Secondly the contents of the IFRS for SMEs will be evaluated against the perceptions of SME accountants in the SME sector. As a result the contents of the IFRS for SMEs will be classified in order of importance.

#### *8.6. Chapter 6 –A comparative evaluation of South African SME financial statements against the IFRS requirements*

The fifth chapter (research article 5) will comprise a comparative study between the contents of the Statement of GAAP for SMEs/IFRS for SMEs and items included in the financial statements by the SME sector in South Africa. The financial data of a sample of SME financial statements will be consolidated/merged into a single set of financial statements. As a result the consolidated financial statements will be compared to the illustrative financial statements contained in the

IFRS for SMEs. The focus of the chapter will be to identify significant items included in the financial statements of SMEs in South Africa and to determine whether the illustrative sample of financial statements envisaged by the IASB can be successfully adopted by the SME sector in South Africa.

#### *8.7. Chapter 7 – Conclusions and summary*

The findings in the preceding chapters will be summarised, recommendations and conclusions will be made regarding the current status of SME accounting in South Africa and the possible impact of the newly adopted Statement of GAAP for SMEs.

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## CHAPTER 2 (Article 1)

# The impact of the Statement of GAAP for SMEs in South Africa<sup>1</sup>

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<sup>1</sup> The reader should take note of the following:

The article has been co-authored with the study promoter and accepted for publication by the following peer reviewed IBSS indexed and Department of Education accredited journal as:

Schutte, D.P. and Buys, P.W. 2010. The impact of the Statement of GAAP for SMEs in South Africa. *Studia Universitatis Babes Bolyai Oeconomica* (unpublished) (ISSN 1220-0506).

The article was researched and written by the first author as the candidate. The 2<sup>nd</sup> author fulfilled a 'reviewer' function thereto as the study promoter. Estimated weightings of contribution are as follows:

- Schutte, D.P. (85%)
- Buys, P.W. (15%)

## **Abstract**

This article aims to consider the impact of the Statement of GAAP for SMEs in South Africa. Even though various support initiatives for small and medium entities (SMEs) have been introduced in recent times, there are also many limiting characteristics of SMEs, such as a lack of 'formality' in terms of accounting procedures. The introduction of International Financial Reporting Standards (IFRS) made it even more difficult for SMEs to adhere to accounting requirements. In 2007 the International Accounting Standards Board (IASB) proposed less stringent reporting requirements for SMEs with the release of the exposure draft on IFRS for SMEs and South Africa became the first country to formally adopt these reporting requirements as a Statement of GAAP. In this study the impact of these reporting requirements on SMEs are explored, based on the current South African SME's reporting and disclosure practices. Phase 1 considered the responses of SME accountants. Phase 2 researched the content and compliance of a sample of SME financial statements. It was found that certain sections included in the Statement of GAAP for SMEs might not necessarily be relevant in the South African context.

**JEL classification:** M41 – Accounting; K2 - Regulation and Business Law (Other); L25 - Firm Performance: Size, Diversification, and Scope.

**Key words:** Accounting, Accounting Practice, International Financial Reporting Standards, Small and Medium Entities, Small GAAP

## **1. Introduction**

### *1.1. Background*

Ever since small, medium and micro-enterprises (SMMEs) have been identified as an important vehicle to address the challenges of job creation, economic growth and equity, the development of SMMEs has been a South African Government priority as a way to achieve sustainable and equitable growth (White paper, 1995:3). Furthermore, the South African Government's Reconstruction and Development Program (RDP) identified SMMEs as a key social and economic development area (White paper, 1995:4), with SMMEs encompassing around one million diversified enterprises that provide job opportunities for around 25% of South Africa's 15 million strong labour force (White paper, 1995:5) and further research in this area was encouraged (White paper, 1995:14; DNT, 2001:27). This resulted in various support initiatives for South African SMEs, including the Small Enterprise Development Agency, the National Small Business Act of 1996, the National Small Business Amendment Act of 2004, the Centre for Small Business Promotion, the Tourism Enterprise Programme, Local Economic Development programmes and the New Venture Creation Learnerships (Philip & Hassen, 2008:11). In addition the Department of Trade and Industry's SME Programme was introduced to ensure that sector development policies incorporate the development, growth and investment measures of SMEs and to maximise small business contribution to the total economy (DTI, 2010:1).

The importance of the small and medium entities (SME) sector has also been internationally recognised. During the latter parts of the 1990's in the United Kingdom (UK), this sector earned annual turnovers of around £1,000 billion (or 45% of the total private sector economic activity) and accounted for 99% of registered businesses. In recognition of this reality, the UK Government introduced its Small Business Service to actively promote the further development of this sector (Johnston & Loader, 2003:273). Furthermore, in the European Union an overall policy position towards the SME sector was adopted, which included the development of more competitive market structures, the removal of legal and administrative constraints on SMEs and encouraging simplified SME accounting procedures (Mulhern, 1996:77). This approach resulted

in the development and implementation of a range of policy measures that are aimed at creating the conditions in which small firms operate, including The Small Business Act for Europe, funding opportunities for SMEs, and other support services across Europe (European Commission, 2010:1).

Despite these support measures the accounting function remains a key constraint facing this sector. SMEs are burdened by a lack of 'formality' in terms of accounting procedures, record keeping and other factors (White Paper, 1995:11). The amount and complexity of the various regulatory and administrative obligations are common complaints by SME owners (European Commission, 2008:7). Moreover, research in the UK found that an inadequate financial accounting function was one of the major reasons for SME failures (Randall & Horsman, 1997:42). In support hereof, Peacock (2000:21) also found a significant relationship between business failure and inadequate accounting records for Australian SMEs.

### *1.2. Regulatory accounting development*

Since its formation in 1973 the International Accounting Standards Committee (IASC) developed 41 International Accounting Standards (IAS). Since the replacement of the IASC by the International Accounting Standards Board (IASB) in 2001, the IASB has developed a further eight International Financial Reporting Standards (IFRS) in addition to the existing 41 IASs, resulting in a total of 49 international accounting standards (Sowden-Service, 2007:5). In pursuit of its objective to develop a single set of high quality, global accounting standards, the IASB cooperates with the national accounting standard-setters in many countries and as of March 2004, a total of 92 countries have agreed to assist in the development of such standards (Sowden-Service, 2007:4; Taylor, 2003:27).

In 1993 the South African Accounting Practice's Board (APB) committed itself to eliminate the differences between South African accounting standards and international accounting standards. To that effect, it was decided to issue IFRSs without any amendments as South African accounting standards as from February 2004, with the result that South African accounting standards issued ever since are identical to the relevant IFRS issued by the IASB (Vorster, Koornhof, Oberholster, Koppeschaar, Coetzee, Janse van Rensburg & Binnekade, 2007:2)

Even though legal backing for accounting standards has been introduced in countries such as the USA, Canada, the UK, Australia and New Zealand, such backing in South Africa remained uncertain until the end of 2006. As a result of proposals by the King Committee on Corporate Governance in 1994 (King I) and in 2002 (King II), it was decided to give such legal backing by comprehensive proposed amendments to the Companies Act, 1973 (Vorster *et al.*, 2007:5). However, at the time of this study these amendments have still not taken effect. It is therefore possible that non-publicly listed South African companies and close corporations are currently not complying with accounting standards due to i) uncertainty regarding the legal backing of the accounting standards for entities incorporated in terms of the Companies Act, 1973 and ii) no specific requirement to comply with accounting standards for entities incorporated in terms of the relevant act (Close Corporations Act, 1984).

### *1.3. Development of differential reporting*

The introduction of IFRS and the alignment of South African accounting standards thereto made it even more difficult for SMEs to adhere to accounting procedures and requirements due to the comprehensive disclosure requirements when compiling IFRS financial statements. It was therefore suggested that an alternative set of accounting requirements be developed for private companies, SMEs and other smaller entities (Zanzig & Flesher, 2006:1; Stainbank & Wells, 2005:55).

A key difference between publicly listed companies and private companies can be seen in the relationship between the company and its accountant. In the case of publicly listed companies the (public) accountant primarily serves the interests of *external parties* such as the shareholders and other stakeholders. In contrast, in private companies (including SMEs), the primary relationship is between the accountant and the *client* (Zanzig & Flesher, 2006:2). Barrar, Wood, Jones and Vedovato (2002:213) also found that publicly listed companies normally have efficient in-house accounting departments as opposed to the smaller companies for which an outsourced accounting function often proved to be more beneficial.

When evaluating company financial statements, Collis and Jarvis (2000:12) as well as Falk, Gobdel and Naus (1976:87) found that finance providers are interested in amongst others, the following:

- In the case of private companies the balance sheet disclosures tend to be important, while the income statement tend to be more important for publicly listed companies;
- Information regarding the company's obligations, such as contingent liabilities and commitments, leases and long-term debt, is typically very important;
- The disclosure of accounting policies, particularly with regard to changes in accounting methods, is considered important; and
- Commercial lending officers often encourage their customers to have audited financial statements.

Even though Wilson (1980:1) indicated that the key users of SME financial statements do not have much different informational needs than those of publicly held entities, there was little evidence of research into the types of decisions being made by the users of SME financial statements. In 1995, the Private Companies Practice Executive Committee of the American Institute of Certified Public Accountants (AICPA) joined the debate by claiming that one of the most significant concerns of its members practicing in small firms is that of accounting standards overload (Zanzig & Flesher, 2006:4). As a direct result of these concerns, the Private Company Financial Reporting Task Force commenced with research into:

- Whether the financial statements of private companies prepared in accordance with generally accepted accounting principles (GAAP) meet the financial reporting needs; and
- Whether the cost of providing GAAP financial statements is justified considering the benefits provided to private-company constituents.

(Zanzig & Flesher, 2006)

The task force concluded that, in certain circumstances, it would be useful if the underlying accounting requirements for non-public companies were different than those for public companies. In addition, it was also found that, although respondents rated certain GAAP

requirements low on decision/relevance usefulness, respondents did appear to believe that the benefits of complying with GAAP outweigh the costs. Their recommendation relating to differential accounting for private companies was furthermore supported by the inadequacy of having a single set of GAAP that is geared for public companies, as well as the different reporting environments between public and private companies. In line with the South African government support for the economical development of SMEs as mentioned earlier, the FASB Chairman, Robert Herz, made the following statement in 2005 (Zanzig & Flesher, 2006:7):

“Private companies are a vital force in the nation’s economy and it is, therefore, critical that their financial reporting be conceptually sound, cost effective, and provides relevant, reliable and useful information.”

Even though the findings by the Private Company Financial Reporting Task Force made a crucial contribution towards the concept of GAAP for private companies, it should be noted that the Task Force is based in the USA. Questions can be asked as to whether the accounting environment in the USA also applies to other parts of the world, in particular to developing countries. Powell (2007:1) noted the impact of different cultures and ethical environments on the harmonisation of the accounting standards in emerging economies, such as in Bangladesh where international donor pressure resulted in a very difficult and less successful implementation of IFRS. Furthermore, in other developed economies, such as Australia (Holmes, Kent & Downey, 1991:125) and Canada (Mersereau, 2002:1), research found that a comprehensive set of reporting requirements are not necessarily appropriate to all companies and compliance therewith can result in substantial costs being incurred without sufficient benefit. More recently, Burgess (2007:14) also emphasised the need for separate accounting standards to apply to private companies which publish general-purpose statements but are not otherwise publicly accountable. In 2000 a discussion paper issued by the South African Institute of Chartered Accountants (SAICA) entitled “Limited Purpose Financial Statements” proposed lesser disclosure requirements for companies that are closely held and controlled by owners and whose financial statements are only available to a limited user audience (SAICA, 2000:4).

If differential reporting is adopted, the basis of differentiation should be decided upon. In the UK, Australia and New Zealand differentiation was initially based on the size of an entity

(Heymans, 2000:1). According to Heymans (2000:1) the pivotal issue of differentiation is however based on whether financial statements are prepared for general use (typically those of publicly traded enterprises) or for limited use (typically owner managed enterprises). In addition, if accounting rules are differentiated, one also needs to decide whether differentiation should be restricted to disclosure or whether recognition and measurement issues should also be considered. Heymans (2000:1) concluded that relief should only be provided for disclosure and should not be extended to recognition and measurement issues around SME accounting. In 2001 SAICA issued a paper on the distinction between small and large enterprises/entities which concluded that qualitative measures, i.e. user informational needs, are the appropriate criteria for determining which entities should qualify to prepare financial statements in accordance with limited purpose financial reporting standards (SAICA, 2001:6).

#### *1.4. IFRS for Small and Medium Size Entities*

The South African Statement of GAAP for SMEs was based on the IASB developed IFRS for SMEs issued as an exposure draft (ED) in February 2007. Even though the contents of the ED have been criticised in the UK (Mackintosh, 2008:83; Temkin, 2007:1), the original text of the proposed IFRS for SMEs has been adopted in South Africa without any change. The APB has decided that in applying the Statement of GAAP for SMEs, the following applies (SAICA, 2007:1):

- **Companies:** The Statement of GAAP for SMEs may be applied by 'limited interest companies', as defined in the Corporate Laws Amendment Act, 2006, provided they do not have public accountability as defined in Section 1 of the Statement of GAAP for SMEs;
- **Entities other than companies required to comply with a reporting framework** (other than Statements of GAAP): Such entities cannot apply the Statement of GAAP for SMEs even if they do not have public accountability as defined in Section 1 of the Statement of GAAP for SMEs; or
- **Entities other than companies not required to comply with a reporting framework:** If such entities do not have public accountability, as defined in Section 1 of the Statement of

GAAP for SMEs, they should assess whether it is appropriate to apply the Statement of GAAP for SMEs.

According to SAICA (2007:2) the Statement of GAAP for SMEs is approximately 15 percent the size of a full set of IFRS/SA GAAP, watering down the 41 IASs and 8 IFRSs into a single accounting statement (see annexure A for the detailed sections of the Statement of GAAP for SMEs).

## **2. Problem statement and hypothesis**

It cannot be denied that the South African SME sector is an important contributor to the overall economy. Major characteristics and constraints identified for this sector include a lack of proper accounting systems and adherence to a comprehensive list of accounting requirements (White paper, 1995:7). A key objective of the IFRS for SMEs (known as the Statement of GAAP for SMEs in the South African context) is to develop a set of high quality, understandable and enforceable global standards for this sector (SAICA, 2007:4). Therefore, the primary research question, from the preparers of SME financial statement's perspective, can thus be formulated as follows:

*P<sub>1</sub>*: To what extent will the IFRS for SMEs be able to address the reporting requirements of South African SMEs?

Based on this problem statement, the following research objectives have been formulated:

- To evaluate the reporting requirement of South African *preparers* of SME financial statements; and
- To determine the extent to which the contents of the IFRS for SMEs are *currently included* in the SME financial statements.

A crucial step in the development of new legislation is the evaluation of the various legislative proposals and consultation with the stakeholders (DoJ, 2004:1). If legislation is enacted without such evaluation and consultation, the proposed legislation might not meet its objectives. Likewise, if SME accounting and financial reporting standards are introduced without a proper evaluation and consultation, it is likely that its ultimate objectives will not be achieved. Based hereupon, the following testable hypothesis can be formulated:

*H<sub>1</sub>*: The current proposed IFRS for SMEs will only be able to address the reporting needs of the SME sector in South Africa to a limited extent.

### 3. Material and method

#### 3.1. Research method

The research was conducted in two stages encompassing both a literature and empirical study. The first stage literature study was aimed at setting the scene by providing the theoretical framework for the current development and status of SME accounting and reporting standards, both from international and South African contexts as well as forming the basis of the questionnaire to be used during the empirical stage. The empirical stage was an exploratory study of an ongoing research project into the current perceptions and practices of SME accounting practitioners and was performed in two phases:

- **Gauging preparer perceptions:** During the first phase, a survey was conducted at a recent North West regional member forum of the South African Institute of Professional Accountants (SAIPA). The target population was the 110 members of the SAIPA North West region, of which 42 members participated in the project, resulting in a 38% response rate; and
- **Evaluating the current practices:** During the second phase, a sample of financial statements were analysed in the context of the Statement of GAAP for SMEs. This analysis was completed on 20 sets of financial statements compiled by different SME practitioners,

based on the target sample identified in phase 1 above and included financial statements compiled by various accounting firms throughout the North West region in South Africa.

### *3.2. Data collection*

The first phase's research questionnaire was developed based on the underlying literature study and consisted of ten questions, utilising an appropriate four-point Likert-type response scale (See annexure B for the complete questionnaire). The researcher was present during the survey in order to provide guidance and clarification respondents might have had with regards to the questionnaire.

In order to meet its objectives, the structured questionnaire had three objectives, namely i) to understand issues around the current status of reporting, ii) to understand accountants' perceptions of informational and decision making requirements, and iii) to gauge the implications of compliance with the Statement of GAAP for SMEs.

The respondents were considered a reliable source due to the close relationship between SME accountants and SME owners (Zanzig & Flesher, 2006:2). It is suggested that, due to this close relationship, the respondents could provide valuable insight into the financial reporting and related purpose of SME financial statements.

During the execution of the second phase of the empirical study, a comparative analysis was completed by analyzing the contents of current SME financial statements against the content requirements of the Statement of GAAP for SMEs.

## **4. Empirical results**

### *4.1. Phase 1: Research questionnaire results*

The following section provides the results and analysis of the responses received. Figure 1 below presents the accounting average of the total responses received in respect of each of the questions posed.

**Figure 1 – Analysis of feedback from SAIPA practitioners**

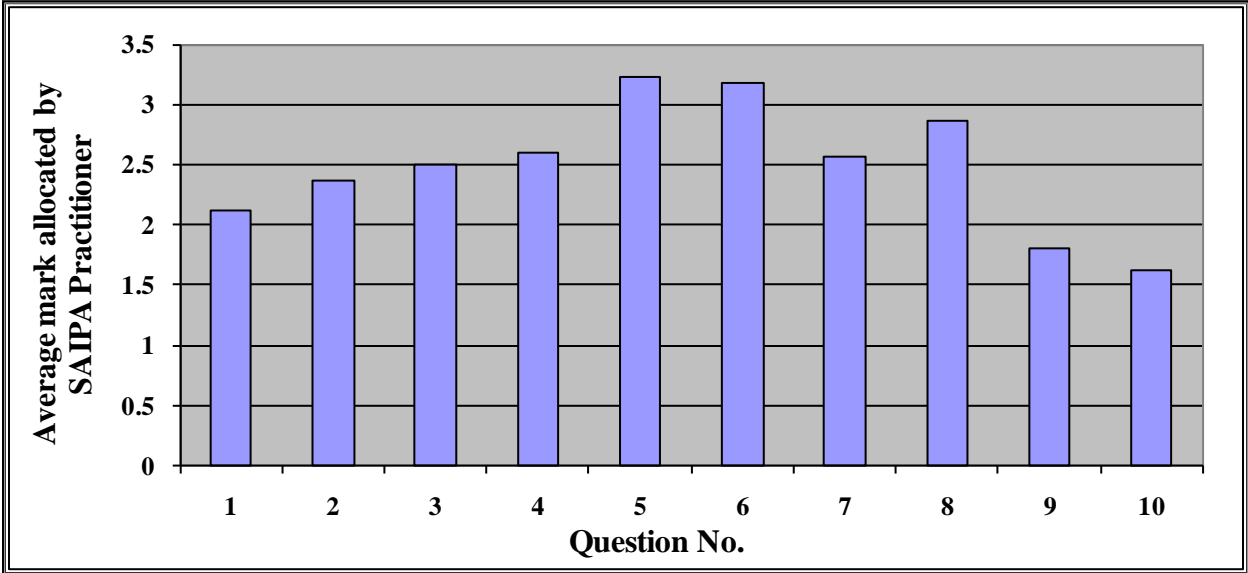
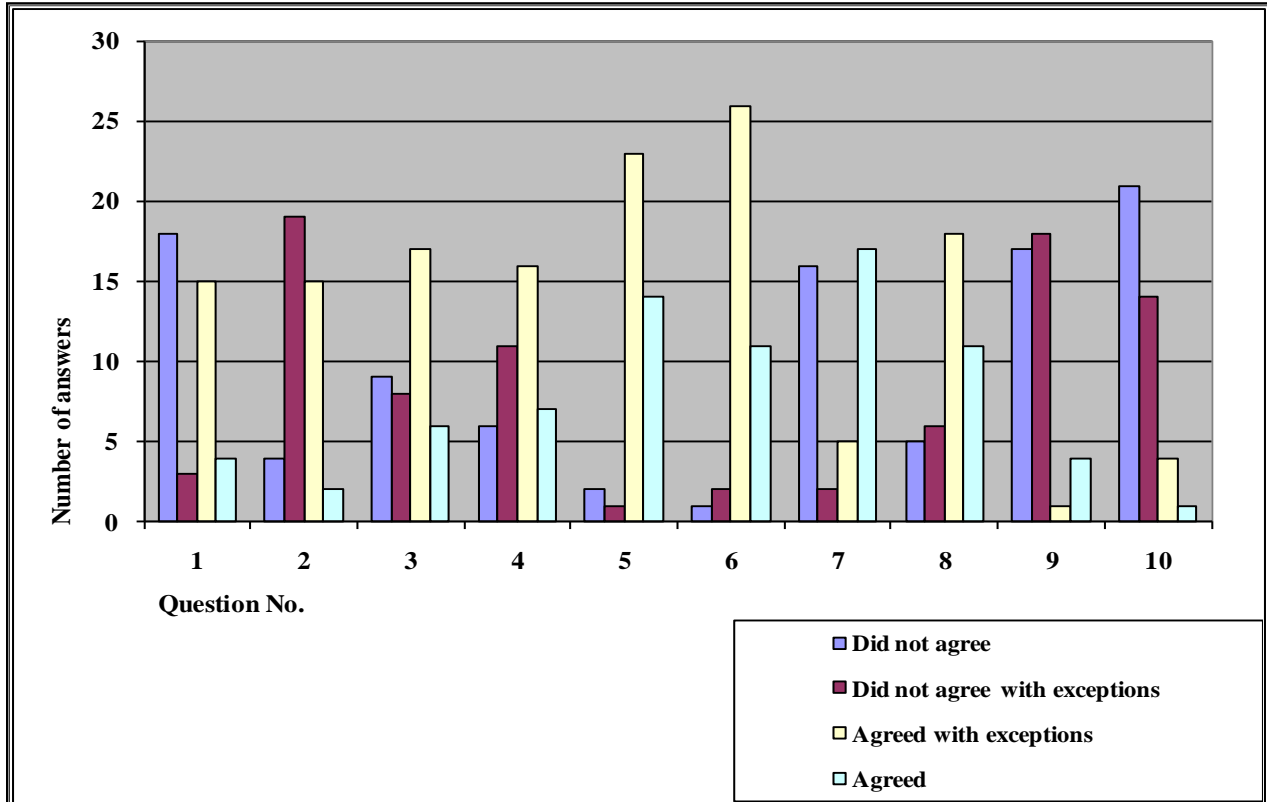


Figure 2 below provides further analysis of the answers by providing the relative responses received in each of the scaled indicators for each of the questions posed as well as relevant descriptive statistics. The average marks in figure 1 were based on the individual answers in figure 2.

**Figure 2 – Analysis of answers per question and descriptive statistics**



Question No.	N	Minimum	Maximum	Mean	Std. Dev.	Skewness	Std. Error	Kurtosis	Std. Error
1	40	1	4	2.13	1.114	.211	.374	-1.553	.733
2	40	1	4	2.38	.740	.056	.374	-.168	.733
3	40	1	4	2.50	1.013	-.234	.374	-1.042	.733
4	40	1	4	2.60	.955	-.208	.374	-.803	.733
5	40	1	4	3.23	.733	-1.205	.374	2.584	.733
6	40	1	4	3.18	.636	-.786	.374	2.478	.733
7	40	1	4	2.58	1.394	-.133	.374	-1.907	.733
8	40	1	4	2.88	.966	-.638	.374	-.394	.733
9	40	1	4	1.80	.911	1.275	.374	1.208	.733
10	40	1	4	1.63	.774	1.129	.374	.884	.733
Valid N	40								

#### *4.1.1. Section I: Issues around the current status of reporting*

Question 1 asked about the practitioners' ability to compile useful SME financial statements and question 2 enquired about the practitioners' ability to interpret fellow practitioners' prepared financial statements. The responses received to these questions resulted in the calculation of the following accounting averages (Figure 1 and 2):

##### *Question 1 (score 2.125)*

Subject to exceptions it would therefore seem as if the responding SAIPA members do not have total confidence to compile financial statements that is useful for decision-making purposes without specific reporting regulations.

##### *Question 2 (score 2.375)*

No clear answer was obtained with regards to the interpretation of financial statements of fellow-practitioners as the average answer was almost between the two extremes. Conversely, it could be argued that almost 50% of practitioners find it difficult to interpret colleagues' financial statements.

#### *4.1.2. Section II: Informational needs and decision making*

In the second section, question 3 asked the practitioners whether they consider decision making at SMEs similar as at larger enterprises while question 4 enquired whether they consider the users of financial statements of small and large enterprises essentially the same. Question 5 asked whether the practitioners consider the preparation of SME statements as mainly for the providers of business finance, while question 6 focussed on the relevant importance of the income statement in a SME environment. Based on the responses received to these questions, the following accounting averages were calculated (Figure 1 and 2):

##### *Question 3 (score 2.5) and question 4 (score 2.6)*

No conclusions could be reached regarding decision making and users of financial statements in connection with small and large entities. The average answer obtained for both questions was mid-way in between the two extremes. A possible explanation for inconclusive answers for

questions 3 and 4 could be attributable to the fact that the respondents were mainly involved in smaller clients and therefore not exposed to larger environments.

*Question 5 (score 3.225) and question 6 (score 3.175)*

Subject to exceptions, the majority of the respondents were of the opinion that financial statements for small entities are mainly compiled for the bank and other providers of finance and that the income statement is mainly used to evaluate a business' performance. This finding seems to be in line with that of Rossouw and Watson (2008).

*4.1.3. Section III: Implications of compliance with the Statement of GAAP for SMEs*

In the final section, question 7 enquired from the members whether they had the opportunity to comment on the statement before it was introduced. Question 8 asked whether they consider that compliance to the statement would be of long-term benefit to their clients, while question 9 asked whether their clients would be willing to pay more for compliant financial statements, and finally question 10 enquired about the perceived benefit of such compliance. Based on the responses received, the following accounting averages were calculated (Figure 1 and 2):

*Question 7 (score 2.575)*

No clear answer was obtained as to whether SAIPA practitioners had the opportunity to comment on the Statement of GAAP for SMEs. The average answer obtained was almost half-way in between the two extremes. Of particular concern is the fact that the answer could also be interpreted as a considerable number (approximately 50%) of members who did not participate (i.e. providing comments) in the developing process of the Statement of GAAP for SMEs.

*Question 8 (score 2.875)*

The number of members who were of the opinion that compliance with reporting standards would result in goodwill with their clients was marginally more than those opposing this statement.

*Question 9 (score 1.8)*

Subject to exceptions the majority of members indicated that they cannot charge their clients more for more complete and technically correct reporting.

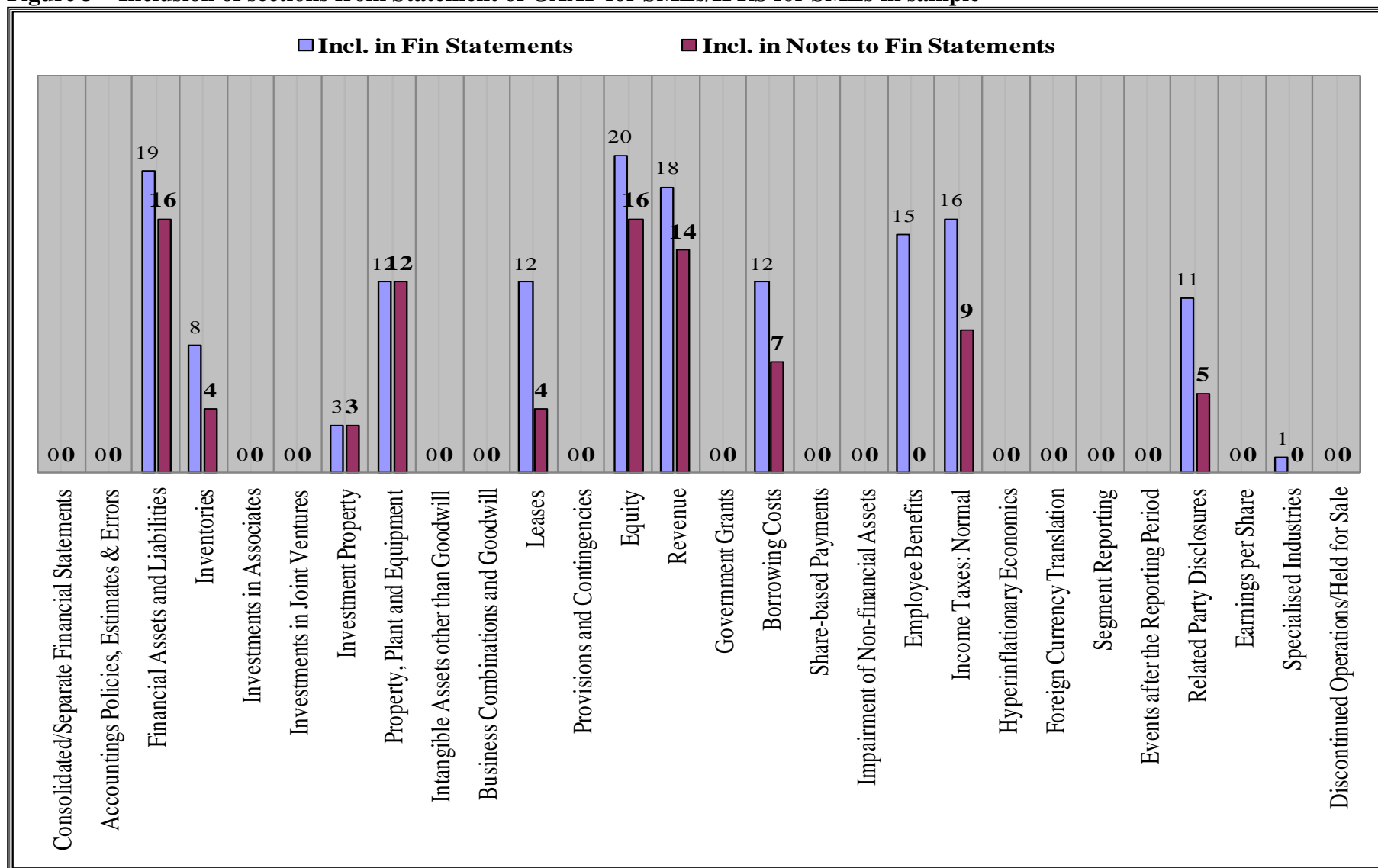
*Question 10 (score 1.625)*

Subject to exceptions more or less the same number of members than question 9 was also of the opinion that a tax saving carries more weight than technically correct financial statements.

*4.2. Phase 2: SME financial statement disclosure analysis*

The following section presents the findings of the analysis of current SME financial statements to gauge their compliance with the requirements of the Statement of GAAP for SMEs. Figure 3 below illustrates the inclusion of the sections of the Statement of GAAP for SMEs in the sample of financial statements.

**Figure 3 – Inclusion of sections from Statement of GAAP for SMEs/IFRS for SMEs in sample**



Based on the analysis in figure 3 it was found that the following sections from the Statement of GAAP for SMEs were not included at all in the sample of financial statements:

**Table 1 – Sections not included in sample of financial statements**

Section	Topic
1	Consolidated and Separate Financial Statements
2	Changes in Accountings Policies, Estimates and Errors
5	Investments in Associates
6	Investments in Joint Ventures
9	Intangible Assets other than Goodwill
10	Business Combinations and Goodwill
12	Provisions and Contingencies
15	Government Grants
17	Share-based Payments
18	Impairment of Non-financial Assets
21	Hyperinflationary Economics
22	Foreign Currency Translation
23	Segment Reporting
24	Events after the End of the Reporting Period
26	Earnings per Share
28	Discontinued Operations and Assets held for Sale

A total number of 16 sections, representing 57% of the total number of sections of the Statement of GAAP for SMEs were not included by the sampled financial statements. It therefore appears that, based on the above information, the sampled SMEs' *do not* i) hold majority or significant investments in other entities (sections 1 and 5), ii) enter into joint ventures and business combinations (sections 6 and 10), iii) change accounting policies and estimates, nor do they correct any errors (section 2), iv) have any intangible assets (section 9), v) disclose any

provisions and contingent liabilities nor report on events after the balance sheet date (sections 12 and 24), vi) overstate its tangible assets (section 18), vii) properly disclose its discontinued operations and non-current assets held for sale (section 28), viii) make use of government grants, or provide share-based payments, foreign currency translation, segment reporting or earnings per share (sections 15, 17, 22, 23 and 26) or ix) experience hyperinflationary economic situations (section 21).

The following sections from the Statement of GAAP for SMEs were included in the sample of financial statements (ascending order as per number of inclusions):

**Table 2 – Sections partially included in the sample of financial statements**

<b>Section</b>	<b>Topic</b>	<b>No. of entities (inclusion in financial statements</b>	<b>No. of entities (inclusion in the notes)</b>
27	Specialized Industries (Agriculture)	1	0
7	Investment Property	3	3
4	Inventories	8	4
25	Related Party Disclosures	11	5
8	Property, Plant and Equipment	12	12
11	Leases	12	4
16	Borrowing Costs	12	7
19	Employee Benefits	15	0
20	Income Taxes	16	9
14	Revenue	18	14
3	Financial Assets and Liabilities	19	16
13	Equity	20	16

The following additional points were noted when the data was analyzed. Employee benefits only included short-term benefits in the form of salaries and other remuneration. There were no provisions for leave or related expenses. Long-term benefits were also not included and in only one case deferred tax was disclosed.

It appears, based on the above information, that the majority of the SMEs included the following sections from the Statement of GAAP for SMEs in the financial statements, namely i) income taxes (section 20), ii) revenue (section 14), iii) financial assets and liabilities (section 3) and iv) equity (section 13). The majority of the entities did not disclose supporting notes/accounting policy notes for the following sections, namely i) income taxes (section 20), ii) employee benefits (section 19), iii) leases (section 11) and iv) related party disclosure (section 25).

## **5. Discussion and conclusion**

### *5.1. Phase 1 – Feedback from practitioners*

#### *5.1.1. Section I: Issues around the current status of reporting*

Burgess (2007:14) identified the need for separate accounting standards for private companies and related SMEs which publish general-purpose statements but are not otherwise publicly accountable. It was found that the majority of members do not feel comfortable to compile financial statements without prescribed accounting requirements or related accounting guidance. Furthermore, approximately 50% of the respondents indicated that they find it difficult to interpret financial statements compiled by colleagues. It could therefore be argued, based on this exploratory study, that accountants of SMEs require accounting guidance applicable to their unique environment that is not as stringent and difficult to apply as is the case with conventional IFRS.

### *5.1.2. Section II: Informational needs and decision making*

Based on feedback from SAIPA practitioners it was not possible to identify distinctive user informational needs pertaining to larger and smaller clients. Furthermore, the feedback obtained from the practitioners suggest that the income statement is considered important when SMEs are evaluated and that SME financial statements are mostly compiled for banks and other providers of finance.

### *5.1.3. Section III: Implications of compliance with the Statement of GAAP for SMEs*

The exploratory study revealed that a considerable number of members did not participate in the development and subsequent adoption of the Statement of GAAP for SMEs (approximately 50%). It is therefore not clear whether the accounting environment from an SME background was indeed incorporated in the Statement of GAAP for SMEs, or whether it is merely a scaled down version of the full version of the accounting rules and regulations applicable to public and large entities.

### *5.2. Phase 2 – Sample SME financial statements*

The study also revealed that a considerable number of sections of the Statement of GAAP for SMEs were not included in the financial statements compiled for the sampled SMEs. From the total sections included in the Statement of GAAP for SMEs a total number of 57% was not included in the sample of financial statements at all. Although further research might indicate otherwise, possible explanations for the omitted sections may be formulated as follows:

- Consolidated and separate financial statements, investments in associates, investments in joint ventures and business combinations and goodwill, segment reporting and earnings per share could have been omitted due to the small nature of SMEs included in the sample.
- Hyperinflationary economics and foreign currency translation could have been omitted based on the fact that SMEs are not subject to hyperinflationary conditions in South Africa. In addition to this the omission might also indicate that SMEs in South Africa do not enter into transactions with entities abroad.

- The omission of changes in accounting policies, estimates and errors, provisions and contingencies and events after the end of the reporting period remains unclear. It is for example reasonable that such errors would occur at (at least) some SMEs. Further research should be conducted into the reason for the omission and the current accounting treatment of the above-mentioned.
- The omission of intangible assets other than goodwill, impairment of non-financial assets and discontinued operations and assets held for sale could also not be properly explained. Further research should be conducted into the accounting treatment of the above-mentioned and to consider whether the above-mentioned omissions were not perhaps incorrectly classified.
- The omission of government grants and share-based payments could also not readily be explained. Further research should be conducted to find explanations why government grants are not applicable to SMEs in view of various support initiatives by the South African government for SMEs. In view of Black Empowerment Economic (BEE) regulations in South Africa the lack of share-based payments could also be investigated.

In addition to the above-mentioned omissions the disclosure for the following sections appears to be incomplete and/or inadequate, including employee benefits other than salaries and other short-term remuneration, deferred tax, leases and related party disclosures. In further support of the findings by the Private Company Financial Reporting Task Force in connection with the benefits of complying with GAAP the research revealed that although compliance with reporting standards might have certain positive outcomes, several similar issues are also identified in the South African environment, including an unwillingness of clients to pay more for technically correct reporting and the fact that a tax saving carries more weight than technically correct financial statements.

Based on feedback obtained from SAIPA practitioners and the contents of a sample of SME financial statements the hypothesis cannot be rejected. It is therefore suggested that the adoption of the IFRS for SMEs in the South African context might be easier said than done.

## **6. Limitations and future research**

The major limitation of this exploratory study is the fact that the respondents were from the North West province only. The sample size of the SME financial statements included in this study could also be seen as a limitation. The possibility that the participants are not representative of all SME accountants in South Africa could therefore not be ruled out. Moreover, the financial statements selected are also not necessarily representative of all SME transactions and events disclosed in the South African context. It is therefore suggested that further research is conducted in connection with the preparation of SME financial statements in South Africa. It is also suggested that research is conducted to consider the impact of other factors when adopting global accounting standard for the SME sector.

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DNT *see* Department: National Treasury.

DoJ *see* Department of Justice.

DTI *see* Department of Trade and Industry.

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## **Annexure A – Statement of GAAP for SME sections**

The following sections are included in the Statement of GAAP for SMEs ( SAICA, 2007:3):

- Scope
- Concepts and Pervasive Principles
- Financial Statement Presentation
- Balance Sheet
- Income Statement
- Statement of Changes in Equity and Statement of Income and Retained Earnings
- Cash Flow Statement
- Notes to the financial statements
- Consolidated and Separate Financial Statements
- Accountings Policies, Estimates and Errors
- Financial Assets and Liabilities
- Inventories
- Investments in Associates
- Investments in Joint Ventures
- Investment Property
- Property, Plant and Equipment
- Intangible Assets other than Goodwill
- Business Combinations and Goodwill
- Leases
- Provisions and Contingencies
- Equity
- Revenue
- Government Grants
- Borrowing Costs
- Share-based Payments
- Impairment of Non-financial Assets

## **Annexure A – Statement of GAAP for SME sections (continued)**

- Employee Benefits
- Income Taxes
- Hyperinflationary Economics
- Foreign Currency Translation
- Segment Reporting
- Events after the End of the Reporting Period
- Related Party Disclosures
- Earnings per Share
- Specialised Industries
- Discontinued Operations and Assets held for Sale
- Interim Financial Reporting
- Transition to the IFRS for SMEs

## Annexure B – Research questionnaire

Name: \_\_\_\_\_

Tel: \_\_\_\_\_

Please allocate marks to each question as follows:

1. Do not agree
2. Do not agree subject to exceptions
3. Agree subject to exceptions
4. Strongly agree

<b>SECTION I: Issues around the current status of reporting</b>				
1. I am able to compile, without specific regulations, financials statements that would provide users of financial statements with relevant information for decision-making purposes.	1	2	3	4
2. I find it difficult to interpret colleagues and fellow practitioners' financial statements when a new client is taken over	1	2	3	4
<b>SECTION II: Informational needs and decision making</b>				
3. Decision making at a small enterprise is in essence the same as that of a large enterprise	1	2	3	4
4. The users of financial statements of a small enterprise are in essence the same than the users of a large enterprise	1	2	3	4
5. With a small enterprise financial statements for decision-making purposes are mainly compile for the bank and other providers of finance	1	2	3	4
6. At a small enterprise the income statement is mainly used to evaluate a business	1	2	3	4

<b>SECTION III: Implications of compliance with the Statement of GAAP for SMEs</b>				
7. I had an opportunity to comment regarding the contents of the Statement of GAAP for SMEs	1	2	3	4
8. Compliance with reporting standards would result in the long term in goodwill with my clients	1	2	3	4
9. My clients are willing to pay more for more complete and technically correct reporting	1	2	3	4
10. Technically correct reporting carries more weight than a tax saving	1	2	3	4

## **Annexure C – Guide for authors (Studia Oeconomica Universitatis Babes Bolyai)**

The articles can be written in English, French or German. Before being accepted for publication, the articles must be sent in two copies printed on paper and on a CD (Word only) on the address: Studia Oeconomica, 58-60 Teodor, Mihali street, Room 231, 400591 Cluj-Napoca, Romania or by e-mail on the address: [oeconomica@econ.ubbcluj.ro](mailto:oeconomica@econ.ubbcluj.ro).

In the first stage, before being accepted for publication, the articles will be presented in the following way:

- (1) The text: between 10 and 20 printed pages (orientation: Portrait), numbered, recto only, A4 format, characters Arial 10, and spacing "Single". Margins: top & bottom: 4.8 cm, left & right: 4 cm, header & footer: 4.8 cm.
- (2) The first page (which will be eliminated in order to make the evaluation, by one of the Advisory Board members, anonymous) must contain the title of the article, the author's name; his/her complete coordinates (professional address, phone, E-mail) and potential thanks for the technical and/or the financial help. The title must be precise, clear and in agreement with the main theme of the text. The authors must make sure that they cannot be identified when reading the manuscript.
- (3) The second page will contain the title of the article and an abstract (in English) of 5-10 lines, which should present the main results of the article. The summary must inform the reader about the content of the article. The summary must be followed by the JEL Classification and by 3-6 keywords in English which define best the article.
- (4) The text will start properly on page 3.
- (5) In the introduction, the author must present the relevance of the article for the respective field and must quote the main results obtained by other authors concerning the subject. The conclusions must summarize clearly the results and the consequences.
- (6) The presentation of the bibliographical references:
  - In the text the references quotes will appear between brackets, with the name and the publication date, e.g.: (Denicolo, 2000).
  - For two co-authors they will use for example (Dixit and Stiglitz, 1977). - In the case of three or more than three authors, only the first will be mentioned, under the form (Brooks et al., 1998).
  - If two references have the same author and the same publication year, they will be differentiated through letters (McFadden, 1984a). These letters will also appear in the bibliography. At the end of the article the references will be presented as follows:
    - Periodicals:  
Chernozhukov V., Hansen C., Jansson M. (2007) Inference approaches for instrumental variable quantile regression, *Economics Letters*, 95 (2), 272-277
    - Books:  
Biswas T. (1997) *Decision-making under Uncertainty*, Macmillan Press, London
    - Chapters in books:

Leventhal G.S. (1980) What should be done with equity theory? New approaches to the study of fairness in social relationships. In: Gergen K., Greenberg M., Willis R. (Eds.), *Social Exchange: Advances in Theory and Research*. Plenum, New York, NY, pp. 27-55.

- Conferences:

Homburg C., Hoyer W.D., Fassnacht M. (2000) When do retailers offer services? An analysis of environmental, store, and store's customers' characteristics?, AMA marketing educators' winter conference, San Antonio, TX

- Working papers:

Smarzynska B.K., Wei S.J. (2000) Corruption and composition of foreign direct investment: firm level evidence, NBER Working Paper 7969, Cambridge, MA

- Quotes of personal works:

If the author wants to make reference to one or several personal works, it is essential that the used formulation preserve his anonymity. In the first sent version, before being accepted for publication, if the quotation of a personal work is absolutely necessary, the author may use the formulation (author, 2001) both in the text and in the bibliography. The bibliographical references will be completed after the article is accepted for publication.

(7) After the article is accepted for publication, the final and complete version of the article must be sent on CD or by E-mail. The article will be written in Microsoft Word.

(8) Studia Universitatis Babeş-Bolyai, *Oeconomica* requires the exclusivity of the article. The same article mustn't be proposed simultaneously to other journals.

## CHAPTER 3 (Article 2)

# Understanding alternative perceptions of accounting practices and standards: An examination of cross-country cultural difference in accounting students<sup>2</sup>

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<sup>2</sup> The reader should take note of the following:

The article has been submitted to the following peer reviewed Department of Education accredited journal as:

Schutte, D.P., Andrikopoulos, P. and Buys, P.W. 2010. Understanding alternative perceptions of accounting practices and standards: An examination of cross-country cultural difference in accounting students. *South African Journal of Accounting Research* (unpublished) (ISSN1010-8270).

The article was researched and written by the first author as the candidate. The 2<sup>nd</sup> author collected the data from the accounting students at the De Montford University in the UK and provided assistance with the statistical analysis. The 3<sup>rd</sup> author fulfilled a 'reviewer' function thereto as the study promoter. Estimated weightings of contribution are as follows:

- Schutte, D.P. (80%)
- Andrikopoulos, P. (10%)
- Buys, P.W. (10%)

## **Abstract**

Globally accountants adopted accountancy practices to suit their unique cultural and business environment, which often makes cross-border comparison of financial statements difficult.

Research revealed that culture often dictates the accounting environment. It is therefore evident that culture is a key concomitant of accounting development, including accounting training, standard setting and application.

This study considers the impact of different cultural backgrounds, as defined by the Hofstede and Gray methodologies, on accountancy students. Using a sample consisting of final-year accounting students from two different universities in South Africa and one in the UK, our results suggest that culture plays an important role in accounting education; as well as it can affect the acceptance and understanding levels of proposed accounting standards by these students.

**JEL classification:** K2, L25, M41

**Key words:** Accounting, accounting education, accounting values, culture, GAAP, IFRS.

## 1. Introduction

Due to globalisation of the business environment and the adoption of International Financial Reporting Standards (IFRS) by approximately 100 countries, accounting practices are no longer constrained by international borders. The development of a single global set of accounting standards is further supported by recent reports in connection with co-operation between the International Accounting Standards Board (IASB) and the American Financial Accounting Standards Board (FASB) (Gornik-Tomaszewski & McCarthy, 2003:35; Goldberg, Grant & Stovall, 2006:35). According to Marrero and Brinker (2007:17) co-operation between the IASB and FASB will yield a uniform body of accounting standards. It is therefore foreseen that IFRS per the IASB and US Generally Accepted Accounting Principles (US GAAP) per the FASB should be incorporated into a single set of accounting standards. The likelihood of a single global set of accounting standards was further supported by Sir David Tweedie who said that by December 2011, U.S. GAAP and IFRS “should be pretty much the same” (Tsakumis, Campbell & Doupnik, 2009:34). However, whether this vision will become a reality remains uncertain.

As early as the mid 1960's Mueller (1965:386) and Kollaritsch (1965:382) considered the potential impact of differences in the accounting systems as utilised in different countries. Today the phenomenon of different accounting approaches/systems for different countries still prevails. In recent times Gujarathi (2008:95) researched the effect of US GAAP and Japanese GAAP on financial statements and concluded that financial statements often need to be restated in order to permit any meaningful cross-border comparison of financial information and ratios. Under ideal circumstances the necessity to restate financial statements in evaluating financial data across borders should be eliminated if a single global set of accounting standards is adopted. Lin and Wang (2001:263) however, revealed significant discrepancies in the financial information disclosed by companies in China and Hong Kong notwithstanding the prevailing accounting rules and applied international accounting standards. They suggested that there is a substantial gap between the practices of corporate accounting in China and internationally accepted norms. In Korea a change in approach was listed as a prerequisite for the successful adoption and implementation of IFRS as Korean GAAP is rules based whilst IFRS is principles based (Ernst

& Young, 2005:1). In addition a number of publications was issued in recent times where local GAAP was compared to IFRS. A sample of these comparisons is presented in table 1.

**Table 1: Comparison of IFRS and Local GAAP**

<u>Country</u>	<u>Local GAAP</u>	<u>Year of publication</u>
The Netherlands	Dutch GAAP	2009
Czech Republic	Czech GAAP	2009
Australia	Australian FRS	2005
Belgium	Belgian GAAP	2006
Germany	German GAAP	2010
Denmark	Danish GAAP	2009
India	Indian GAAP	2009
Indonesia	Indonesian GAAP	2005
Italy	Italian GAAP	2008
New Zealand	NZ GAAP	2005
Portugal	SNC	2010
Luxembourg	Luxembourg GAAP	2010
Malaysia	Malaysian FRS	2009
Mexico	Mexican GAAP	2009
Thailand	GAAP in Thailand	2008
Russia	Russian Accounting Standards	2009
Slovak Republic	Slovak GAAP	2004

(PWC, 2010; Deloitte, 2010)

A study in Western Europe revealed differences in the levels of transparency in the process of adopting IFRS (Steffee, 2009:1). In Canada, apart from the fact that IFRS is due to be implemented in 2011, the Canadian Accounting Standards Oversight Council was requested to delay the implementation date due to competing regulatory requirements, lack of rules clarity, education and resource shortages (FEI Canada, 2007:1). Education also lacked behind in the United States as a survey conducted there revealed that the first graduating class of accounting students to enter the workforce with a substantial knowledge of IFRS education may only be the class of 2015 – three years later than initially expected (WEB CPA, 2009:1).

Considering all the above it therefore appears that not much has changed since the observations by Mueller (1965:386) and Kollaritsch (1965:382) in connection with different accounting practices by different countries. A single global set of accounting standards is still only a panacea to be realised. The USA follows US GAAP, most of Europe and certain other countries adopted IFRS whilst various local GAAP versions still prevail elsewhere. Research also indicated that countries are not necessarily complying with existing accounting standards (e.g. in China); countries experienced difficulties preparing for the implementation of IFRS (e.g. in Canada); countries in the same region did not follow similar approaches implementing IFRS (e.g. in Western Europe); and countries in the process of adopting IFRS have experienced delays in the education process (e.g. Canada and the United States). It is therefore evident that a number of factors are influencing the current and future adoption of IFRS across international borders. These factors may include “non-accounting” influences unique to each country, for example its culture, history, geography, alternative socio-economic and political systems, legal and taxation systems, professional governing bodies, religion, language and education. Although most of these factors will determine the status quo and the framework within which the accounting profession operates, elements such as education, culture and social beliefs play an important role in shifting current perceptions while facilitating the evolution of the profession in the years to come.

## **2. Research problem and objective**

Following on all the above, this paper aims to examine the impact of alternative cultures and

beliefs on the way accounting students understand accounting standards. The study is structured as follows: section three describes the general theoretical framework and covers the relevant literature review. Section four introduces the hypothesis to be tested in the study; while section five introduces the methodology and the data sample. All results are presented and discussed in section six and the study concludes in section seven. According to our results, culture, beliefs and socio-economic background affects the understanding of the discipline and its key standards, as well as reflecting the wider attitude towards the way it will be practiced in the future.

### **3. Theoretical framework**

#### *3.1. Accounting practices and the impact of culture*

When IFRS was introduced the general consensus was that the process of comparing the financial performance of market participants would improve (Beuselinck, Joos & Van der Meulen, 2007:3; Hamberg, Novak & Paananen, 2006:3). Observers however, also warned about the possibility of discrepancies in the process of adopting IFRS due to different views relating to the application of the standards and different backgrounds of preparers of financial statements from different countries (Perramon & Amat, 2006:6; Diaconu & Coman, 2006:11; Procházka, 2010:19).

Radebaugh's (1997:46) argument that "accounting is a product of its environment" is supported when HassabElnaby, Epps and Said (2003:273) emphasised the importance of environmental factors in modelling a country's accounting system. This has led to various attempts to identify both the relevant environmental factors and the manner by which such factors influence accounting. A possible environmental factor, as suggested by Garcia-Sordo and Baren (1999:314), relates to the impact of differences in national cultures on the accounting function. According to Perera (1989:43) culture is the most powerful environmental factor affecting the accounting system of a country. Mueller, Gernon and Meek (1997:10) argued that all the things that we learn, observe, feel, believe or prioritize have cultural dimensions. According to Marrero and Brinker (2007:18) human beings assign specific values to their own realities, which result in certain principles or laws that are considered as the norms or customs within a specific group of

society. The development of these norms and customs is consequently influenced by race, geographic areas and other factors that could either be original or inherited from other groups. Hofstede (1983:75) defined culture as combined patterns of thoughts which distinguish one category of people from those of another. The common element in all these definitions is the perception of culture as a "programming of the mind" (Marrero & Brinker, 2007:18).

The impact of culture on accounting has been investigated by a number of researchers. From the perspective of teaching and training of prospective accountants, Lindahl and Fanelli (2002:285) and Sullivan (2006:1-13) identified teaching challenges for students with different cultural backgrounds and considered the impact of cultural issues on accounting students. In addition, from the perspective of accounting legislation and standard setting, Violet (1983:2) concluded that different cultures produce unique accounting structures shaped by a multitude of cultural constraints and variables. McKinnon (1986:72-73) further confirmed this hypothesis by providing cultural explanations for accounting changes/developments in Japan. Xiao, Weetman and Sun (2004:193) investigated the effect of accounting tradition and cultural factors on accounting regulation while Bloom and Naciri (1989:72) concluded that accounting standard setting is influenced by the economic, political and social environment (culture) of that country. Finally, from the perspective of the practical application of accounting, early research by Jaggi (1975:76) concluded that cultural differences between developed and less developed countries may often result in differences in accounting disclosure. Belkaoui (1990:5) suggested that culture dictates the accounting environment and the cognitive functioning of individuals faced by an accounting phenomenon. Jaggi and Low (2000:495) as well as Ding, Jeanjean and Stolowy (2005:325) investigated the roles of culture and legal origin in explaining disclosure levels. It is therefore evident that culture is very often considered a key concomitant of accounting development, including accounting training, accounting standard setting and accounting applications.

### *3.2. From cultural dimensions to accounting values*

Hofstede (1980:25) was one of the main authors to recognise the importance of culture on the work environment. In his seminal work, he identified the following four major measurable

cultural dimensions:

- *Individualism versus collectivism*, which relates to the relationship between the individual and the group in which a high individualism ranking indicates dominant individual rights within a society;
- *Power distance*, which relates to social inequality in relation to authority, with high power distance ranking being an indication that people accept rigid hierarchical orders;
- *Masculinity versus femininity*, which relates to the social implications of being born as a male or a female, where *masculinity* stands for qualities such as assertiveness and material success while *femininity* stands for qualities such as caring relationships and quality of life; and
- *Uncertainty avoidance*, which relates to the ability to deal with uncertainty, the control of aggression and the expression of emotion, where cultures with a higher uncertainty orientation often punish deviation from norms to encourage conformity.

More recently Hofstede (2008:1) developed an additional three cultural dimensions namely i) long- versus short-term orientation, ii) indulgence versus restraint, and iii) monumentalism versus self-effacement individualism. Since this study is based on the interaction of Gray's accounting values/attributes, which is based on only the first four cultural dimensions by Hofstede, it was decided not to include these additional three dimensions in this article's consideration of the cultural impact of accounting students.

Gray (1988:5-8) extended Hofstede's earlier cultural framework to financial accounting systems and suggested that accounting values are derived from cultural dimensions and that accounting values, in turn, influence accounting systems. Gray (1988:8) identified the following four accounting values: i) *professionalism versus statutory control*, which refers to professional judgement and self regulation as opposed to compliance with prescriptive legal requirements and statutory control, ii) *uniformity versus flexibility*, which refers to the enforcement of uniform and consistent accounting practices as opposed to flexibility in accordance with the perceived circumstances of individual companies, iii) *conservatism versus optimism*, which refers to a cautious approach to accounting measurement as opposed to a more optimistic and risk-taking

approach and iv) *secrecy versus transparency*, which refers to confidentiality and the restriction of disclosure of information as opposed to a more transparent, open and publicly accountable approach.

As a result of the interaction between Hofstede's cultural dimensions and Gray's accounting values, Gray (1988:8-11) developed the following hypotheses:

- The higher the *individualism* ranking and the lower the *uncertainty avoidance* and *power distance* rankings, the more likely it is to rank highly in terms of *professionalism*.
- Conversely the higher the *uncertainty avoidance* and *power distance* rankings and the lower the *individualism* ranking then the more likely it is to rank highly in terms of *uniformity*.
- The higher the *uncertainty avoidance* ranking and the lower *individualism* and *masculinity* rankings then the more likely it is to rank highly in terms of *conservatism*.
- The higher the *uncertainty avoidance* and *power distance* rankings and the lower the *individualism* and *masculinity* rankings then the more likely it is to rank highly in terms of *secrecy*.

The above hypotheses are supported by further independent empirical research. Sudarwan (1994:8) used linear structural relations to test the validity of Gray's model and found that all four the accounting values are confirmed by Indonesian accounting practices. Salter and Niswander (1995:379) also concluded that Gray's model has statistically significant explanatory power; while Willett (2002:31) provides support for Gray's accounting value constructs of *uniformity*, *professionalism* and *secrecy*. Finally, Olimid (2006:1) found evidence in Romania for the first three of Gray's hypotheses while, Askary (2006:102) confirmed the effects of culture on accounting *professionalism* in twelve developing countries including Iran, Bangladesh, Jordan, Oman and Qatar.

#### **4. Development of hypothesis**

Based on the foregoing arguments it seems as if the effect of cultural differences on the

accounting environment cannot be denied. As different perceptions and values could lead to different appreciation of the accounting regulations and standards, this research attempt to initially determine and evaluate cultural values of accounting students of different cultural and socio-economic backgrounds within South Africa, and then, compare both groups with a sample of accounting students of a Western European country, the United Kingdom (UK). Therefore, our hypothesis can be formulated as:

*H<sub>1</sub>*: There are cultural differences to be expected between the accounting students across the individual university campuses in South Africa and the UK.

Following this initial examination, we then aim to identify differences in the overall cultural framework as developed by Hofstede and in accounting values in line with Gray's framework. This might help us to understand possible reasons behind the differences between these two countries and between the different areas of South Africa. In addition the participants' understanding could have real-life policy implications with respect to pedagogy and the way academics teach international accounting principles to an international audience.

## **5. Research methodology and data collection**

This study was conducted at three university campuses in two different countries, South Africa and the UK. The selected sample comprises of final year accountancy students from two campuses of the North-West University<sup>3</sup> in South Africa with different cultural backgrounds as well as students from the De Montfort University in the UK. The two campuses from the North West University comprised of the Potchefstroom Campus (PTC) with predominantly white

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<sup>3</sup> On 1 January 2004 the former University of the North West based in Mafikeng and the Potchefstroom University for Christian Higher Education (PU for CHE) merged to form a new institution called the North-West University (NWU).

students and the Mafikeng Campus (MFK) with predominantly black students from historically disadvantaged backgrounds. We also decided to include a control group comprising of students in a UK higher education institution. On that basis, we selected the students of the final year of the B.A. in Accounting and Finance programme of Leicester Business School, De Montfort University (DMU).

The measurement instrument/questionnaire utilised to determine Hofstede's cultural dimensions/values was the 1994 Value Survey Model (annexure A) that uses a five-point Likert scale for all included questions. The Value Survey Model is arguably the most widely utilized instrument to measure cultural differences and has been used in a number of related studies (Torres & Jones, 2010; Crotts & Erdmann, 2000; Huettinger, 2008; Daechun & Sanghoon, 2007; Holden, 2004)). The researchers were present throughout the survey to clarify uncertainties in connection with the questionnaire and the statistical analysis of the data was performed by the Department of Statistical Consultation Services at the North West University.

In the second phase the results of the cultural values for accounting students were extended to the accounting values by Gray. According to table 2, panel A, the sample size consisted of 91 students from the MFK campus, 118 students from the PTC campus and 92 students from the DMU. The sample size represented at least 98% of the registered final year accounting students at the various institutions. With regards the profile of the gender composition, at the MFK campus there was an unequal split between male and female (38% male vs. 62% female) while in all other locations the sample was almost equally distributed. Similarly, according to panel B, the vast majority of the examined sample in all three locations is within the range of 18 to 24 years old, and only a small percentage of students older than 25 years (DMU = 7.6% and MFK = 5.5%). This is good as it gives us the opportunity to study the different perceptions and cultures across the same age of students thus eliminating potential 'noise' created from different age groups and therefore life experiences.

**Table 2: Descriptive Statistics and Sample Properties***Panel A: Gender of Respondents (by examined institution)*

	Potchefstroom Campus (n=118)	Mafikeng Campus (n=91)	De Montfort University (n=92)
Male	49%	38%	51%
Female	51%	62%	49%
	<b>100%</b>	<b>100%</b>	<b>100%</b>

*Panel B: Age Group of the Respondents (by examined institution)*

	Potchefstroom Campus (n=118)	Mafikeng Campus (n=91)	De Montfort University (n=92)
<24	100%	94.5%	92.4%
25-29	0.0%	2.2%	0.0%
30-34	0.0%	1.1%	5.4%
35-39	0.0%	2.2%	2.2%
40-49	0.0%	0.0%	0.0%
50-59	0.0%	0.0%	0.0%
60 or over	0.0%	0.0%	0.0%
	<b>100%</b>	<b>100%</b>	<b>100%</b>

As regards the analysis stage, the use of Likert scales requires the use of a ranking procedure with “1” being minimum and “5” being maximum score. However, the analysis of commonality

(or the lack thereof) amongst the alternative sample groups will be initially estimated using an independent groups *t*-Test. The whole process is carried out into two stages with the formal stage assessing the key underlying assumptions of homogeneity of *k*-sample variances and then, if this is found to be insignificant we then proceed with the estimation of the relevant *t*-statistic.

The assessment of the homogeneity of variances is carried out using the Levene's test. Our decision is based on the properties of the test as being less sensitive to possible departure from normality. On that basis, we test the hypothesis that the variance across all sample groups, examined in pairs, for a variable *G* is significantly different in statistical terms; while the relevant test-statistic, using the comparison between the PTC and MFK campuses as an example, is estimated as:

$$W = \frac{N - 2}{k - 1} \frac{\sum_{i=1}^k N_i (\bar{Z}_i - \bar{Z}_{i..})^2}{\sum_{i=1}^k \sum_{j=1}^{N_i} (Z_{ij} - \bar{Z}_i)^2} \quad [1]$$

where, *N* is the sample size; *k* is the number of observations of the subgroups within the sample;  $Z_{i,j}$  is the difference between each observation of the variable *G* for both subgroups *i* and *j* (PTC and MFK campuses respectively) and the arithmetic mean of the *i*<sup>th</sup> subgroup ( $\bar{G}_i$ ) or  $Z_{ij} = |G_{ij} - \bar{G}_i|$ ; *N<sub>i</sub>* is the sample size of the *i*<sup>th</sup> subgroup;  $\bar{Z}_i$  are the group means for  $Z_{ij}$ ; and,  $\bar{Z}_{i..}$  is the overall mean of the  $Z_{ij}$ . Equality of group variances (or lack of) is assessed by comparing the value of *W* with the upper critical value of the *F*-distribution.

Based on the Levene's test findings, we then carry out the independent t-test as normal for all cases where the variance between the two subgroups is similar; while, for the case of unequal variance, statistical significance is assessed using the Welch *t*-statistic<sup>4</sup>.

The cultural value systems and attitudes of all data samples are estimated using Hofstede's

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<sup>4</sup> The Welch *t*-test is the most conventional methodology for assessing independent group t-statistic under the assumption of unequal group sizes and unequal variances.

(1994) methodology in estimating the four indices of i) *Power Distance*, ii) *Individualism*, iii) *Masculinity*, and iv) *Uncertainty Avoidance*. Each of these systems represents one of the four typical dimensions of a national cultural system, while the review of individual campus' scores in all the above four indices will allow the identification of each campus' performance in terms of Gray's accounting values. Finally, the assessment of statistically significant difference in the average score between institutions is carried out using a conventional independent two-sample *t*-Test but adjusted for case of unequal group sizes.

## **6. Empirical results**

### *6.1. Results from independent sample t-Test*

A summary of the sample statistics is presented in table 3. According to the results, for most questions, the answers appear to be within a similar range. However, certain minor differences in the cultural values of the survey participants need to be highlighted. For example, participants from DMU and PTC appear to value more highly the importance of having sufficient time for personal and family life as examined by question one (1.75 and 1.69 for DMU and PTC campuses, compared to 2.055 for MFK). The results for the standard deviation indicate reasonable variation in the answers from the participants with that of MFK reporting a slightly higher standard deviation (0.921) compared to the other two institutions.

**Table 3 – Sample Statistics and Frequency of Responses**

	<i>Campus</i>	DMU (n=92)	PTC (n=118)	MFK (n=91)	Total (n=301)		<i>Campus</i>	DMU (n=92)	PTC (n=118)	MFK (n=91)	Total (n=301)
Q1	$\mu$	1.750	1.695	2.055	1.821	Q11	$\mu$	2.054	1.788	1.835	1.884
	$\sigma$	0.897	0.891	1.047	0.953		$\sigma$	0.843	0.761	0.992	0.866
	<i>Std. Error</i>	0.093	0.082	0.110	0.055		<i>Std. Error</i>	0.088	0.070	0.104	0.050
Q2	$\mu$	1.794	1.653	1.703	1.711	Q12	$\mu$	2.207	2.195	2.473	2.282
	$\sigma$	0.792	0.881	0.937	0.872		$\sigma$	0.989	0.972	1.068	1.012
	<i>Std. Error</i>	0.083	0.081	0.098	0.050		<i>Std. Error</i>	0.103	0.090	0.112	0.058
Q3	$\mu$	1.783	1.839	1.659	1.767	Q13	$\mu$	2.630	2.839	2.868	2.784
	$\sigma$	0.708	0.915	0.846	0.836		$\sigma$	0.911	0.795	0.636	0.794
	<i>Std. Error</i>	0.074	0.084	0.089	0.048		<i>Std. Error</i>	0.095	0.073	0.067	0.046
Q4	$\mu$	1.576	1.653	1.571	1.605	Q14	$\mu$	3.152	3.212	3.286	3.216
	$\sigma$	0.759	0.900	0.956	0.876		$\sigma$	0.864	0.904	1.003	0.922
	<i>Std. Error</i>	0.079	0.083	0.100	0.051		<i>Std. Error</i>	0.090	0.083	0.105	0.053
Q5	$\mu$	1.761	1.788	1.637	1.734	Q15	$\mu$	3.163	3.441	3.846	3.478
	$\sigma$	0.732	0.932	0.837	0.846		$\sigma$	0.987	0.882	0.930	0.965
	<i>Std. Error</i>	0.076	0.086	0.088	0.049		<i>Std. Error</i>	0.103	0.081	0.098	0.056
Q6	$\mu$	2.120	2.212	2.209	2.183	Q16	$\mu$	3.033	3.136	3.451	3.199
	$\sigma$	0.862	0.856	0.863	0.858		$\sigma$	1.063	0.969	1.195	1.080
	<i>Std. Error</i>	0.090	0.079	0.091	0.050		<i>Std. Error</i>	0.111	0.089	0.125	0.062
Q7	$\mu$	1.511	1.534	1.626	1.555	Q17	$\mu$	2.946	2.619	2.824	2.781
	$\sigma$	0.687	0.844	1.007	0.853		$\sigma$	0.918	1.053	1.198	1.067
	<i>Std. Error</i>	0.071	0.078	0.106	0.049		<i>Std. Error</i>	0.096	0.097	0.126	0.062
Q8	$\mu$	1.957	2.017	2.011	1.997	Q18	$\mu$	2.826	2.932	2.714	2.834
	$\sigma$	0.901	0.887	1.038	0.936		$\sigma$	1.075	0.985	1.259	1.101
	<i>Std. Error</i>	0.094	0.082	0.109	0.054		<i>Std. Error</i>	0.112	0.091	0.132	0.064
Q9	$\mu$	1.707	1.585	1.747	1.671	Q19	$\mu$	3.011	2.534	2.429	2.648
	$\sigma$	0.871	0.880	1.060	0.935		$\sigma$	1.084	1.027	1.222	1.129
	<i>Std. Error</i>	0.091	0.081	0.111	0.054		<i>Std. Error</i>	0.113	0.095	0.128	0.065
Q10	$\mu$	2.337	2.119	2.429	2.279	Q20	$\mu$	3.109	2.746	3.253	3.010
	$\sigma$	0.829	0.730	0.921	0.830		$\sigma$	1.172	1.031	1.270	1.168
	<i>Std. Error</i>	0.086	0.067	0.097	0.048		<i>Std. Error</i>	0.122	0.095	0.133	0.067

Moreover, the respondents from the PTC campus appear to be marginally more persistent and strong-minded with an average score of 2.054 for question eleven compared to an average of 1.788 for MFK and 1.835 for DMU respectively.

Finally, a very interesting difference amongst all three campuses is the answer to question fifteen that examines whether or not “most people can be trusted”. The UK participants appear to be the ones that exhibit most disagreement in such statement with an average score of 3.84 and standard deviation of 0.93. The respondents from the South African universities appear more inclined to trust other people ( $\mu$ -value of 3.16 with standard deviation (s.d.) of 0.987 for PTC and  $\mu$ -value of 3.44 with s.d. of 0.882 for MFK).

Testing the indifference hypothesis between all three participating institutions further elaborates the cultural diversity of the respondents. According to table 4 below a comparison between PTC and MFK reveals the presence of important cultural differences between these two campuses. Based on the Levene’s test results as summarised on table 4, panel A, in 7 out of the 20 questions examined, the variance appears to be unequal violating one of the key assumptions of the independent samples *t*-Test (questions 10, 11, 13, 16, 18, 19 and 20). Following these results, the *t*-statistic for these questions is then estimated with the Welch’s correction with the findings presented in table 2, panel B. Out of the 20 questions answered by both PTC and MFK, there is a statistically significant difference in 5 questions (questions 1, 10, 15, 16 and 20).

**Table 4 – Summary of Results from Independent *t*-Test (Potchefstroom vs. Mafikeng)**

**Panel A - Levene's Test for Equality of Variances**

	<i>Q01</i>	<i>Q02</i>	<i>Q03</i>	<i>Q04</i>	<i>Q05</i>	<i>Q06</i>	<i>Q07</i>	<i>Q08</i>	<i>Q09</i>	<i>Q10**</i>
<i>F-statistic</i>	0.410	0.267	0.337	0.078	0.215	0.000	2.142	0.968	1.449	13.067
Sig.	0.523	0.606	0.562	0.780	0.643	0.989	0.145	0.326	0.230	0.000
	<i>Q11**</i>	<i>Q12</i>	<i>Q13**</i>	<i>Q14</i>	<i>Q15</i>	<i>Q16**</i>	<i>Q17</i>	<i>Q18**</i>	<i>Q19*</i>	<i>Q20**</i>
<i>F-statistic</i>	8.878	1.763	6.771	0.253	1.219	10.188	0.691	16.589	6.082	10.305
Sig.	0.003	0.186	0.010	0.615	0.271	0.002	0.407	0.000	0.014	0.002

**Panel B – t-Test for Equality of Means**

	<i>Q01</i>	<i>Q02</i>	<i>Q03</i>	<i>Q04</i>	<i>Q05</i>	<i>Q06</i>	<i>Q07</i>	<i>Q08</i>	<i>Q09</i>	<i>Q10</i>
<i>t-statistic</i>	-2.681**	-0.402	1.454	0.629	1.211	0.026	-0.722	0.045	-1.210	-2.635**
<i>Sig.</i>	0.008	0.688	0.148	0.530	0.227	0.980	0.471	0.964	0.228	0.009
<i>μ-Diff</i>	-0.360	-0.051	0.180	0.081	0.151	0.003	-0.092	0.006	-0.163	-0.310
<i>Std Error</i>	0.134	0.126	0.124	0.129	0.124	0.120	0.128	0.133	0.134	0.118
	<i>Q11</i>	<i>Q12</i>	<i>Q13</i>	<i>Q14</i>	<i>Q15**</i>	<i>Q16*</i>	<i>Q17</i>	<i>Q18</i>	<i>Q19</i>	<i>Q20**</i>
<i>t-statistic</i>	-0.375	-1.961	-0.294	-0.558	-3.217	-2.048	-1.317	1.361	0.662	-3.101
<i>Sig.</i>	0.708	0.051	0.769	0.577	0.002	0.042	0.189	0.175	0.509	0.002
<i>μ-Diff</i>	-0.047	-0.278	-0.029	-0.074	-0.405	-0.315	-0.206	0.218	0.105	-0.507
<i>Std Error</i>	0.125	0.142	0.099	0.132	0.126	0.154	0.156	0.160	0.159	0.164

**Notes**

\* Significant at the 0.05 level

\*\* Significant at the 0.01 level

The highest mean difference is reported for question 20 with the respondents of the MFK campus appearing to disagree more to the statement that “failure is ones’ own fault”. Apart from question 16, all other differences in the responses are significant at the one-percent level.

As expected the most significant difference in responses is reported when the South African campuses are compared against DMU. According to table 5, panel B there is evidence of statistically significant differences in the answers provided by the PTC student and those of the DMU. This is reported in 6 out of the 20 questions covered, with most important mean difference of -0.477 in question 19 (*t*-value of -3.259).

**Table 5 – Summary of Results from Independent *t*-Test (Potchefstroom vs. De Montfort)**

**Panel A - Levene's Test for Equality of Variances**

	<i>Q01</i>	<i>Q02</i>	<i>Q03*</i>	<i>Q04</i>	<i>Q05</i>	<i>Q06</i>	<i>Q07</i>	<i>Q08</i>	<i>Q09</i>	<i>Q10**</i>
<i>F-statistic</i>	0.0205	0.0358	4.3780	1.0429	3.0199	0.0000	1.3027	0.9271	0.0095	7.3664
Sig.	0.8863	0.8501	0.0376	0.3083	0.0837	0.9999	0.2550	0.3367	0.9225	0.0072
	<i>Q11</i>	<i>Q12</i>	<i>Q13*</i>	<i>Q14</i>	<i>Q15</i>	<i>Q16</i>	<i>Q17*</i>	<i>Q18</i>	<i>Q19</i>	<i>Q20</i>
<i>F-statistic</i>	1.9669	0.1302	4.9625	2.1961	0.6807	1.7040	4.1812	2.5544	0.7255	2.6105
Sig.	0.1623	0.7186	0.0270	0.1399	0.4103	0.1932	0.0421	0.1115	0.3953	0.1077

**Panel B – t-Test for Equality of Means**

	<i>Q01</i>	<i>Q02</i>	<i>Q03</i>	<i>Q04</i>	<i>Q05</i>	<i>Q06</i>	<i>Q07</i>	<i>Q08</i>	<i>Q09</i>	<i>Q10*</i>
<i>t-statistic</i>	-0.443	-1.202	0.503	0.653	0.231	0.773	0.212	0.487	-0.999	-1.994
<i>Sig.</i>	0.658	0.231	0.615	0.514	0.818	0.441	0.832	0.627	0.319	0.048
<i>μ-Diff</i>	-0.055	-0.141	0.056	0.076	0.027	0.092	0.023	0.060	-0.122	-0.218
<i>Std Error</i>	0.124	0.117	0.112	0.117	0.118	0.119	0.108	0.124	0.122	0.109
	<i>Q11*</i>	<i>Q12</i>	<i>Q13</i>	<i>Q14</i>	<i>Q15*</i>	<i>Q16</i>	<i>Q17*</i>	<i>Q18</i>	<i>Q19**</i>	<i>Q20*</i>
<i>t-statistic</i>	-2.399	-0.085	1.740	0.484	2.148	0.732	-2.400	0.744	-3.259	-2.384
<i>Sig.</i>	0.017	0.932	0.084	0.629	0.033	0.465	0.017	0.458	0.001	0.018
<i>μ-Diff</i>	-0.266	-0.012	0.209	0.060	0.278	0.103	-0.327	0.106	-0.477	-0.363
<i>Std Error</i>	0.111	0.136	0.120	0.123	0.129	0.141	0.136	0.143	0.146	0.152

**Notes**

\* Significant at the 0.05 level

\*\* Significant at the 0.01 level

The examination of variance equality reveals that the smallest number of variance inequality is reported between the PTC campus and the DMU (questions 3, 10, 13, and 17).

Finally, the comparison between the MFK campus and the DMU reveals the biggest difference amongst all three institutions. Using the Levene's test we report unequal variances in 6 out of the 20 questions examined and especially in the five ones before the last that deal with views regarding organisation and management (questions 15 - 19). Testing for equality of means further support these findings, with significant differences reported in questions 1, 13, 15, 16, 19, and 20 (table 6, panel B). The largest differences are reported for questions 15 and 19 ( $\mu$ -difference of 0.683 and -0.582,  $t$ -values of 4.819 and -3.409 respectively).

.

**Table 6 – Summary of Results from Independent *t*-Test (Mafikeng vs. De Montfort)**

**Panel A - Levene's Test for Equality of Variances**

	<i>Q01</i>	<i>Q02</i>	<i>Q03</i>	<i>Q04</i>	<i>Q05</i>	<i>Q06</i>	<i>Q07*</i>	<i>Q08</i>	<i>Q09</i>	<i>Q10</i>
<i>F-statistic</i>	0.2320	0.5156	2.2518	1.4570	1.8871	0.0002	6.2728	0.0222	1.1202	1.1076
Sig.	0.6306	0.4737	0.1352	0.2290	0.1712	0.9899	0.0131	0.8816	0.2913	0.2940
	<i>Q11</i>	<i>Q12</i>	<i>Q13**</i>	<i>Q14</i>	<i>Q15</i>	<i>Q16</i>	<i>Q17*</i>	<i>Q18*</i>	<i>Q19**</i>	<i>Q20</i>
<i>F-statistic</i>	2.4045	0.8615	22.1676	2.8608	2.5358	3.1058	6.1790	5.8520	7.4119	1.9941
Sig.	0.1227	0.3546	0.0000	0.0925	0.1130	0.0797	0.0138	0.0165	0.0071	0.1596

**Panel B** – *t*-Test for Equality of Means

	<i>Q01*</i>	<i>Q02</i>	<i>Q03</i>	<i>Q04</i>	<i>Q05</i>	<i>Q06</i>	<i>Q07</i>	<i>Q08</i>	<i>Q09</i>	<i>Q10</i>
<i>t-statistic</i>	2.116	-0.704	-1.069	-0.037	-1.063	0.700	0.905	0.379	0.284	0.708
<i>Sig.</i>	0.036	0.483	0.286	0.971	0.289	0.485	0.367	0.705	0.777	0.480
<i>μ-Diff</i>	0.305	-0.090	-0.123	-0.005	-0.124	0.089	0.116	0.054	0.041	0.092
<i>Std. Error</i>	0.144	0.128	0.115	0.128	0.116	0.128	0.128	0.144	0.143	0.129
	<i>Q11</i>	<i>Q12</i>	<i>Q13*</i>	<i>Q14</i>	<i>Q15**</i>	<i>Q16*</i>	<i>Q17</i>	<i>Q18</i>	<i>Q19**</i>	<i>Q20</i>
<i>t-statistic</i>	-1.611	1.748	2.049	0.965	4.819	2.500	-0.769	-0.646	-3.409	0.798
<i>Sig.</i>	0.109	0.082	0.042	0.336	0.000	0.013	0.443	0.519	0.001	0.426
<i>μ-Diff</i>	-0.219	0.266	0.238	0.134	0.683	0.418	-0.121	-0.112	-0.582	0.144
<i>Std. Error</i>	0.136	0.152	0.116	0.138	0.142	0.167	0.158	0.173	0.171	0.181

**Notes**

\* Significant at the 0.05 level

\*\* Significant at the 0.01 level

Overall, these findings suggest that on the basis of question 15 response, the MFK accounting students on average appear not to support the view that “most people can be trusted”, while based on the results from question 19, the UK students appear to be less rule-abiding and acting on their own individual beliefs.

## 6.2. Hofstede’s cultural dimensions

The cultural dimensions of accounting students at MFK and PTC in South Africa and the DMU in the United Kingdom are set out in table 7 below.

**Table 7 – Index rating: Cultural dimensions of accounting students**

	<u>DMU</u>	<u>PTC</u>	<u>MFK</u>
Individualism (IDV)	78.91	77.46	59.51
Power Distance (PDI)	11.68	20.97	24.89
Masculinity vs Femininity (MAS)	21.09	53.22	14.95
Uncertainty Avoidance (UAI)	59.95	69.07	88.57

The results indicate that individual rights, as measured by *individualism*, are more dominant at PTC (77.46) than MFK (59.51). There is a strong similarity between *individualism* at the DMU and PTC (a score of 78.91 and 77.46 respectively), perhaps indicative of the European roots<sup>5</sup> at PTC. Societies and cultures with a preference for *individualism* tend to also have a preference for a loosely-knit social framework. Individuals at PTC and DMU are therefore expected to take care of themselves and their immediate families only, whilst individuals at MFK expect their relatives to look after them in exchange for unconditional loyalty.

*Power distance* data revealed that hierarchical orders or the fact that power is not distributed

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<sup>5</sup> White South Africans are descendants of European migration in the 17<sup>th</sup> and 18<sup>th</sup> centuries.

equally is marginally more acceptable at MFK (24.89) than PTC (20.97). *Power distance* at DMU (11.68) is lower than both MFK (24.89) and PTC (20.97). According to Gray (1988:7) cultures with lower *power distances* strive for power equalisation and demand justification for power inequalities. Power inequalities will therefore more often be questioned at the DMU whilst PTC and MFK will accept power inequalities more readily.

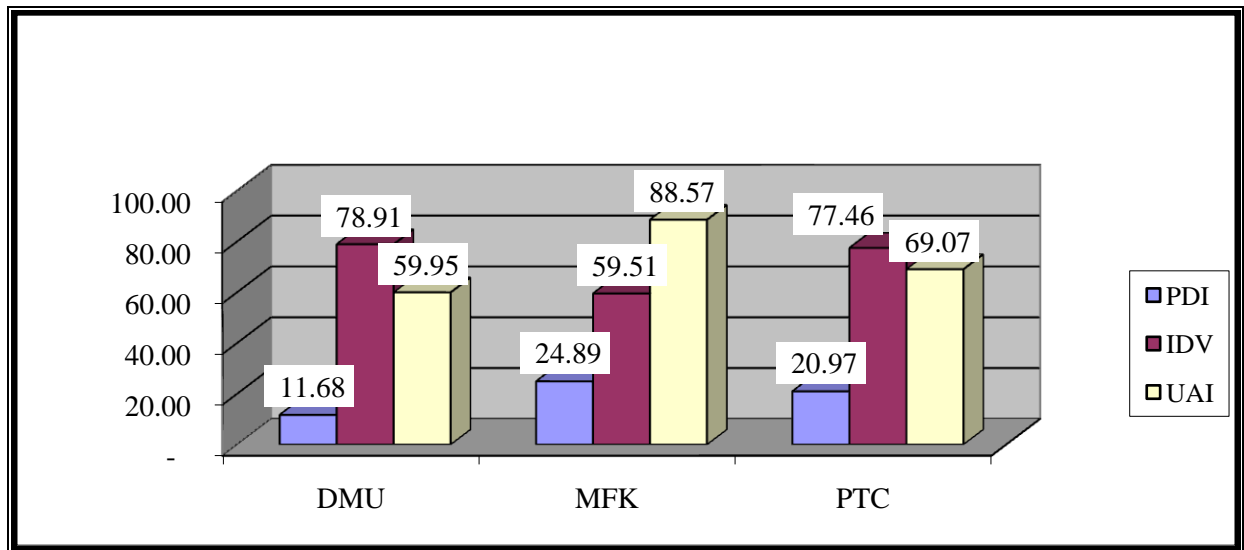
A notable difference relating to *masculinity* versus *femininity* was revealed. The *masculinity* versus *femininity* cultural dimension relates to the social implications of being born as a male or a female. According to Verma (2000:11) *masculinity* stands for qualities such as assertiveness and material success whereas *femininity* stands for qualities such as caring relationships and quality of life. In addition masculine dimensions include a preference for showing off, achievement, heroism, assertiveness, making money, thinking big, etc. On the contrary feminine dimensions include a preference for putting relationships with people before money, helping others, caring for the weak, quality of life, preservation of the environment, etc. It can therefore be concluded that attributes such as assertiveness and material success is significantly more important at the PTC (53.22) than both MFK (14.95) and DMU (21.09).

*Uncertainty avoidance*, or ways of dealing with uncertainty, was assessed to be higher at MFK (88.57) than PTC (69.07). The fundamental issue is how a society reacts to the fact that the future is unknown. Cultures with a higher uncertainty orientation often punish deviation from norms to encourage conformity (Moustafa, Slaubaugh & Wang, 2008:539). In essence the dimension relates to the degree to which the members of society feel uncomfortable with uncertainty and ambiguity. Low *uncertainty avoidance* is an indication that members of a society feel in general secure and will not attempt to control the future through laws. In addition, different ideas and viewpoints will be more easily tolerated as well as a bigger willingness to take risks. Different viewpoints at PTC may therefore more easily be tolerated than MFK. The fact that *uncertainty avoidance* was assessed to be the highest at MFK might therefore be an indication that members of this society feel anxious about the future which might result in measures to add security and avoid risk. *Uncertainty avoidance* at DMU (59.95) was assessed to be lower than both the South African campuses, indicating that people are relatively more secure about the future and that different viewpoints are more easily tolerated at the UK University.

### 6.3. Gray's accounting values

The cultural dimensions considered previously are now extended to the accounting values of Gray (1988:5). Cultural dimensions relevant to *professionalism* versus *statutory control* as well as cultural dimensions relevant to *uniformity* versus *flexibility* are set out in figure 1.

**Figure 1 – Professionalism versus Statutory Control/Uniformity versus Flexibility**



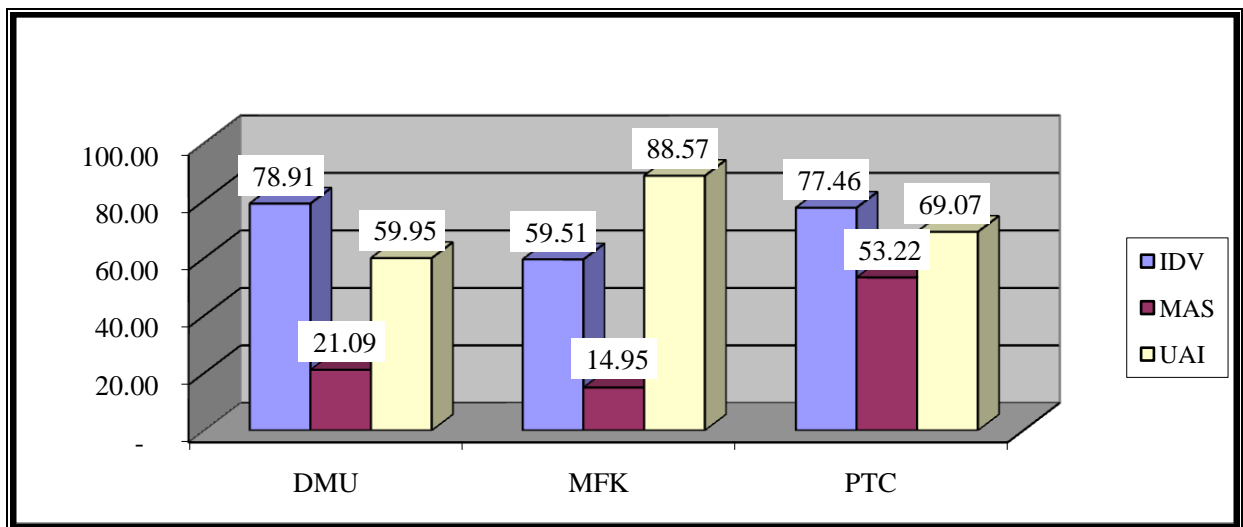
Note: PDI = *Power distance* IDV = *Individualism* UAI = *Uncertainty avoidance*

Gray's first hypothesis suggests that a higher ranking in terms of *individualism* and a lower ranking in terms of *uncertainty avoidance* and *power distance* are indicative of a preference for *professionalism*. Our research revealed that, due to a higher *individualism* ranking and lower *uncertainty avoidance* and *power distance* rankings, PTC (IDV = 77.46/ UAI = 69.07/PDI = 20.97) will rank higher in terms of *professionalism* compared to MFK (IDV = 59.51/UAI = 88.95/PDI = 24.89). *Individualism* at DMU (78.91) is ranked higher than both the South African campuses. The difference between DMU and PTC (77.46) is however only marginally compared to the difference with MFK (59.51). *Uncertainty avoidance* and *power distance* at DMU (UAI = 59.95/PDI = 11.68) is lower than both the South African campuses. *Professionalism* will therefore be more prominent at the UK University.

Gray's second hypothesis suggests that higher *uncertainty avoidance* and *power distance* rankings and a lower *individualism* ranking is indicative of a preference for *uniformity*, suggesting that MFK (UAI = 88.57/PDI = 24.89/IDV = 59.51) will rank higher than PTC (UAI = 69.07/PDI = 20.97/IDV = 77.46) in terms of *uniformity*. Students at PTC will therefore be more *flexible* when applying accounting practices and principles. Students at DMU (UAI = 59.95/PDI = 11.68/IDV = 78.91) will however be even more *flexible* when applying accounting practices as the *power distance* and *uncertainty avoidance* rankings are lower and the *individualism* ranking is higher than both the South African campuses.

Cultural dimensions relevant to *conservatism* versus *optimism* are set out in figure 2.

**Figure 2 – Conservatism versus Optimism**



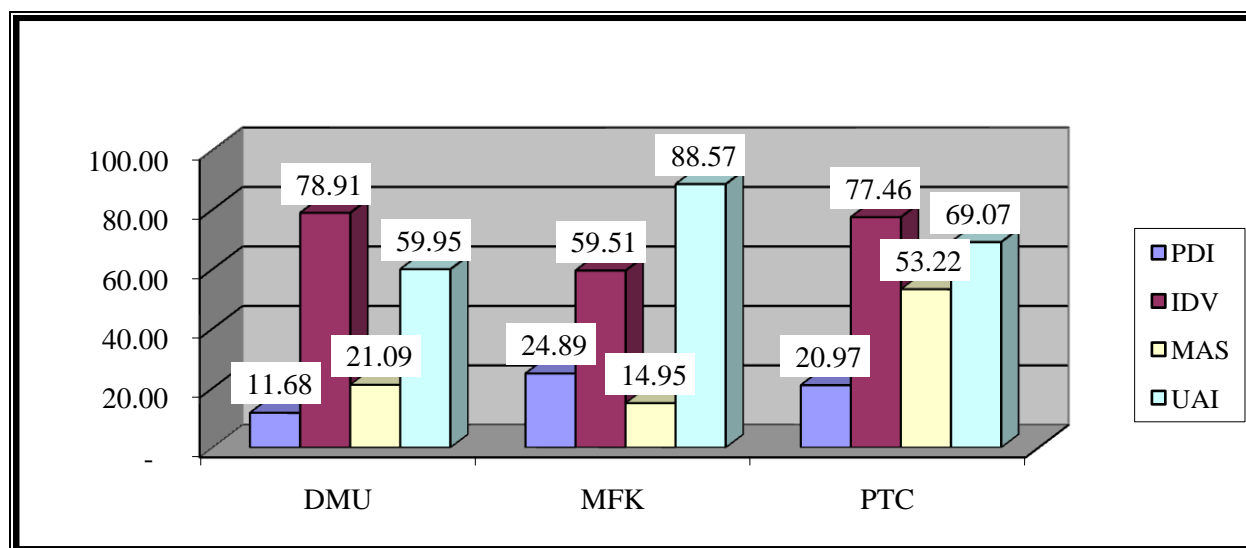
Note: IDV = *Individualism* MAS = *Masculinity* UAI = *Uncertainty avoidance*

Gray's third hypothesis suggests that higher *uncertainty avoidance* and lower *individualism* and *masculinity* are indicative of a preference for *conservatism*. Comparing MFK (UAI = 88.57/IDV = 59.51/MAS = 14.95) to PTC (UAI = 69.07/IDV = 77.46/MAS = 53.22) higher *uncertainty avoidance* together with lower *individualism* and *masculinity* rankings at MFK we suggest that students at MFK will be more cautious in their approach as opposed to a more optimistic and

risk-taking approach at PTC. When comparing DMU (UAI = 59.95/IDV = 78.91/MAS = 21.09) to MFK it is also evident that students at MFK will be more cautious in their approach to measurement due to a higher *uncertainty avoidance* ranking together with lower individualism and masculinity rankings. If DMU is compared to PTC a decisive conclusion cannot be reached as *individualism* and *uncertainty avoidance* rankings indicate that *conservatism* is more relevant at PTC whilst the lower *masculinity* ranking is in favour of *conservatism* at DMU. Due to the fact that Gray (1988:11) indicated that *masculinity* is of somewhat lesser importance relating to accounting values and based on two out of three indicators however we suggest that *conservatism* is favoured at PTC.

Cultural dimensions relevant to *secrecy* versus *transparency* are set out in figure 3.

**Figure 3 – Secrecy versus Transparency**



Note: PDI = *Power distance* IDV = *Individualism* MAS = *Masculinity*

UAI = *Uncertainty avoidance*

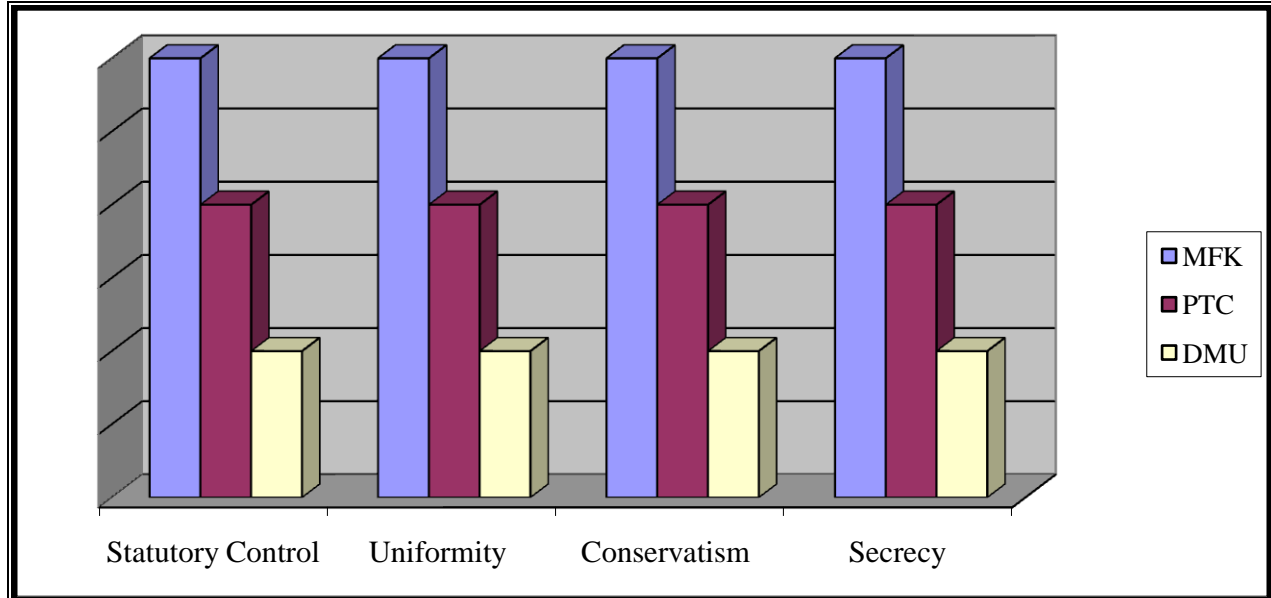
Gray's fourth and final hypothesis suggests that a higher ranking in terms of *uncertainty*

*avoidance* and *power distance* and a lower ranking in terms of *individualism* and *masculinity* is indicative of a preference for *secrecy*. In comparing PTC (UAI = 69.07/PDI = 20.97/IDV = 77.46/MAS = 53.22) and MFK (UAI = 88.57/PDI = 24.89/IDV = 59.51/MAS = 14.95) our research suggests that, based on higher *uncertainty avoidance* and *power distance* as well as lower *individualism* and *masculinity* rankings, *secrecy* will be favoured at MFK. Students at MFK will therefore be more cautious in their approach as opposed to a more optimistic and risk-taking approach at PTC. Students at MFK should therefore prefer confidentiality and the restriction of disclosure of information as opposed to a more transparent, open and publicly accountable approach. As opposed to a preference for confidentiality at MFK, students at DMU (UAI = 59.95/PDI = 11.68/ IDV = 78.91/MAS = 21.09) will be more transparent and open in their approach. All four indicators were in favour of *transparency* at DMU in comparison to MFK whilst three out of the four indicators (*individualism*, *power distance* and *uncertainty avoidance*) revealed that a preference for a transparent approach prevails at DMU when compared to PTC (*Masculinity* was also outscored in the third hypothesis by Gray).

#### 6.4. Gray's accounting value rankings

Based on the above, we allocate the various accounting values to the three institutions included in the survey using a rating system. Hence, if ratings are allocated in units of 1 to 3, where 3 represents a high preference for an accounting value and 1 is representative of a low preference for an accounting value we find a perfect linear relationship between the cultural values identified by Hofstede and the accounting values and related hypotheses of Gray. According to figure 4, the results obtained relating to all four the accounting values of Gray were in the order MFK – PTC and then DMU. The accounting values assigned to PTC are found to be constantly between the other two institutions, perhaps symptomatic of the measure of influence by the African environment on the European culture.

**Figure 4 – Classification of Accounting Values**



When adopting accounting standards on a global basis we suggest that two aspects should be considered. Firstly, in order to avoid discrepancies in the process of adopting accounting standards due to different views and backgrounds of preparers of financial statements (Perramon & Amat, 2006:6; Diaconu & Coman, 2006:11; Procházka, 2010:19; Marrero & Brinker, 2007:18) we suggest that prescriptive guidance should be provided in connection with the adoption of these accounting standards. Based on this assumption we suggest that the following accounting values of Gray are required:

- *Statutory control* in order to adhere to a single set of prescribed rules and regulations in connection with accounting transactions and related disclosure thereof;
- *Uniformity* in order to, irrespective of different backgrounds, apply uniform accounting practices and principles; and
- *Transparency* in order to be open and publicly accountable.

We found that students at MFK have two of the three accounting values deemed necessary to adopt a global *prescriptive* accounting framework. The tendency towards *secrecy* as opposed to *transparency* is however not conducive to the concept of global accounting practices at MFK. Based on our evaluation of accounting values we found that the concept of a global *prescriptive*

accounting framework will be more acceptable to accounting students at PTC when compared to DMU. If PTC is compared to MFK our study revealed a preference for *prescriptive* accounting rules at MFK.

In the second instance, if the fact that IFRS is based on principles ((Ernst & Young, 2005:1) is taken into consideration; we suggest that the following accounting values of Gray should be present:

- *Professionalism* in order to apply professional judgment to specific scenarios;
- *Flexibility* in order to adapt to individual situations and specific scenarios; and
- *Transparency* for purposes of public accountability.

Our research revealed that all these attributes were present at DMU, suggesting that the principles contained in IFRS should be more readily acceptable in the UK. The South African students, and specifically MFK, will find it more difficult to deal with the concept of accounting standards based on principles.

## **7. Discussion and conclusion**

Our evaluation of cultural dimensions of the three campuses in the empirical study revealed that *masculinity* at PTC is significantly higher than the other two campuses MFK and DMU. *Masculinity* at PTC overpowered other cultural indicators 2-1 and 3-1 in deriving at the *conservatism vs optimism* and *secrecy vs transparency* accounting values in the empirical study. When considering their backgrounds it is evident that the students at PTC are predominantly white students from privileged apartheid-era backgrounds. *Masculinity* stands for qualities such as assertiveness and material success. Societies with high *masculinity* ratings value attributes such as income, recognition and advancement. Due to the fact that the *masculinity* rating at PTC is significantly higher than the other two campuses the results could be indicative of the dominant nature and materialistic views of individuals from privileged apartheid-era backgrounds in South Africa. Nadar (2008:1) confirmed this statement by suggesting that the nature of Afrikaner hegemonic masculinity is being challenged by the democratic order ushered

in 1994. It is therefore possible that the concept of a *transparent* and *flexible* approach in applying IFRS is overpowered by individualistic views at PTC.

We observed that the cultural dimension relating to *individualism* at MFK (59.51) was notably lower than PTC (77.46) and DMU (78.91). A high score for this dimension focuses on the “I” whereas a low score focuses on the “we” of a group of individuals. Our study further revealed that *uncertainty avoidance* at MFK (88.57) was higher than PTC (69.07) and DMU (59.95). A high score for this dimension is indicative of a preference for extensive and rigid rules to decrease uncertainty. Deviations from norms will therefore be punished to encourage conformity, individual rights and deviations from norms may therefore not be considered a priority at MFK. We therefore suggest, based on the mentioned cultural dimensions, that the concept of a uniform set of global accounting standards should be more acceptable at MFK due to a lower preference for individual rights or individual accounting scenarios and a deviation from norms.

Our study revealed that the cultural dimension relating to *power distance* at DMU (11.68) was markedly lower than PTC (20.97) and MFK (24.89). It is believed that societies with low *power distance* ratings do not accept hierarchical orders and demand justification for power inequalities. We therefore suggest that the mentioned cultural dimension is not conducive of a prescriptive set of global accounting standards pertaining to all accounting scenarios.

We concluded from the accounting values of Gray that the South African students, and more specifically MFK students, have the majority of the attributes (except for *secrecy*) required to adopt a global set of accounting standards and that the students from the UK will most probably be able to cope with the principles contained in IFRS. As a result we suggest that South African students should firstly be acquainted with the fact that *transparency* is required to adopt a global set of accounting standards, after which they should receive guidance to apply *professionalism* and *flexibility* pertaining to specific IFRS principles.

Considering the findings of this study, it is clear that there are definite cultural differences not only between South Africa and UK accounting students, but also within the South African context. The hypothesis of this study as mentioned earlier is therefore not rejected.

Our recommendations are not only limited to accounting education. It may be argued that the individuals included in the survey are representative of other role players in the accounting environment as human beings assign specific values to their own reality within a specific group of society. Practitioners, governing bodies and standard setters should also take note of the results and related recommendations when adopting the IFRS on a global basis.

## **8. Limitations and future research**

Although our study revealed distinctive accounting values for accounting students from different cultural backgrounds the major limitation of this study is the fact that other cultural backgrounds were not considered within the South African context, as well as for other parts of the world.

Another limitation could be attributable to our assumptions that the adoption of accounting standards is not only dependent on prescriptive guidance but also influenced by the fact that IFRS is based on principles.

We therefore suggest that future research should consider other cultural backgrounds as well as the adoption of global accounting standards by entities without a traditional IFRS focus, such as entities from the SME sector.

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## Annexure A – Value Survey Model 1994

### QUESTIONNAIRE

#### English version

Please think of an ideal job, disregarding your present job, if you have one. In choosing an ideal job, how important would it be to you to ... (please circle one answer in each line across):

1 = of utmost importance

2 = very important

3 = of moderate importance

4 = of little importance

5 = of very little or no importance

- |  |   |   |   |   |   |
|--|---|---|---|---|---|
| 1. have sufficient time for your<br>personal or family life  | 1 | 2 | 3 | 4 | 5 |
| 2. have good physical working<br>conditions (good ventilation<br>and lighting, adequate work<br>space, etc.) | 1 | 2 | 3 | 4 | 5 |
| 3. have a good working relation-<br>ship with your direct superior   | 1 | 2 | 3 | 4 | 5 |
| 4. have security of employment   | 1 | 2 | 3 | 4 | 5 |

5. work with people who cooperate  
well with one another 1 2 3 4 5
6. be consulted by your direct  
superior in his/her decisions 1 2 3 4 5
7. have an opportunity for advance-  
ment to higher level jobs 1 2 3 4 5
8. have an element of variety and  
adventure in the job 1 2 3 4 5

In your private life, how important is each of the following to you? (please circle one answer in each line across):

9. Personal steadiness and stability 1 2 3 4 5
10. Thrift 1 2 3 4 5
11. Persistence (perseverance) 1 2 3 4 5
12. Respect for tradition 1 2 3 4 5

13. How often do you feel nervous or tense at work?

1. never
2. seldom
3. sometimes
4. usually
5. always

14. How frequently, in your experience, are subordinates afraid to express disagreement with their superiors?

1. very seldom
2. seldom
3. sometimes
4. frequently
5. very frequently

To what extent do you agree or disagree with each of the following statements? (please circle one answer in each line across):

- 1 = strongly agree
- 2 = agree
- 3 = undecided
- 4 = disagree
- 5 = strongly disagree

15. Most people can be trusted 1 2 3 4 5

16. One can be a good manager  
without having precise answers to most  
questions that subordinates may  
raise about their work 1 2 3 4 5

17. An organization structure in  
which certain subordinates have  
two bosses should be avoided  
at all costs 1 2 3 4 5

18. Competition between employees  
usually does more harm than  
good 1 2 3 4 5

19. A company's or organization's  
rules should not be broken -  
not even when the employee  
thinks it is in the company's  
best interest 1 2 3 4 5

20. When people have failed in life  
it is often their own fault 1 2 3 4 5

Some information about yourself (for statistical purposes):

21. Are you:

1. male
2. female

22. How old are you?

1. Under 20
2. 20-24
3. 25-29
4. 30-34
5. 35-39
6. 40-49
7. 50-59
8. 60 or over

23. How many years of formal school education (or their equivalent) did you complete (starting with primary school)?

1. 10 years or less
2. 11 years
3. 12 years
4. 13 years
5. 14 years
6. 15 years
7. 16 years
8. 17 years
9. 18 years or over

24. If you have or have had a paid job, what kind of job is it / was it?

1. No paid job (includes full-time students)
2. Unskilled or semi-skilled manual worker
3. Generally trained office worker or secretary
4. Vocationally trained craftsperson, technician, informatician, nurse, artist or equivalent
5. Academically trained professional or equivalent (but not a manager of people)
6. Manager of one or more subordinates (non-managers)
7. Manager of one or more managers

25. What is your nationality?

26. What was your nationality at birth (if different)?

Thank you very much for your cooperation!

## **Annexure B – Guide for authors (South African Journal of Accounting Research)**

### Manuscript Submissions

Authors should submit their manuscripts by e-mail to [sajar@saica.co.za](mailto:sajar@saica.co.za).

Alternatively they may submit 3 hard copies to Prof Enrico Uliana, Editor SAJAR, Department of Finance, Bremner Building, University of Cape Town, Private Bag Rondebosch 7701, South Africa. Manuscripts must include an abstract and up to ten keywords. Manuscripts must be free of any identification of the author(s), affiliations, and acknowledgements. A separate sheet should include the title, affiliation, contact address, phone number, fax and email address and any appropriate acknowledgements. The letter to the editor should contain a statement that the manuscript or a similar one has not been published and is not, nor will be, under consideration for publication elsewhere while being reviewed by SAJAR.

The above instructions must be adhered to for resubmission.

#### 1) Manuscript Preparation and Style

Manuscripts should be prepared for A4 paper and be 1.5 or double-spaced. Authors are requested to use a 12 point easily legible font, and margins should be at least one inch to facilitate editing.

#### 2) References in the text.

- Cited information must be identified accurately. The surname(s) or the author(s), year of publication and page number(s) appear in parentheses after the quotation, for example (Coetzee, 2003:2-5), (Brown & Jones, 2003:2-5). Omit the page number(s) if the entire publication is referred to, for example (Berger, 2001). In works by three or more authors the surnames of all the authors should be given in the first reference to such a work, for example 'A recent study (Jones, Smith, Boren & White, 2002) shows ... .' In later references to this work only the first author's name is given, and the abbreviation et al., a comma and the year of publication. For example: (Jones et al., 2002).
- References at the end of the manuscript. More details about sources referred to in the text must appear at the end of the manuscript under the caption 'References'. All sources must be arranged alphabetically according to the surnames of the first author. If more than one publication by the same author(s) appear in one year they must be distinguished by a, b, etc., for example 2003a, 2003b.
- References from books. After the year of publication, follows the title. The Edition, Place of publication: publisher, total number of pages:

- Steers, R.M. and Porter, L.W. (1991). Motivation and work behaviour. 5th Edition. Singapore: McGraw-Hill.
- References from journals. After the year of publication, follows the title of the article, title of the journal, volume, number, page(s):
- Doyle, R.J. (1983). Gainsharing – A total productivity approach, Journal of Contemporary Business, 11(2):57-70.

### 3) Proof-reading

Final proofs of the paper will be sent to the author for proof-reading. It is in the author's interest and is his/her responsibility to ensure that the paper is error-free.

## CHAPTER 4 (Article 3)

# **Cultural considerations and the Implementation of International Financial Reporting Standards – A focus on Small and Medium Entities<sup>6</sup>**

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<sup>6</sup> The reader should take note of the following:

The article has been co-authored with the study promoter and accepted for publication by the following IBSS indexed peer reviewed Department of Education accredited journal as:

Schutte, D.P. and Buys, P.W. 2010. Cultural considerations and the implementation of International Financial Reporting Standards – A focus on Small and Medium Entities. *Journal of Social Sciences* (forthcoming) (ISSN0971-8923).

The article was researched and written by the first author as the candidate. The 2<sup>nd</sup> author fulfilled a ‘reviewer’ function thereto as the study promoter. Estimated weightings of contribution are as follows:

- Schutte, D.P. (85%)
- Buys, P.W. (15%)

## **Abstract**

Research revealed that inconsistent accounting practices are often attributable to environmental factors of which cultural differences appear to be the most significant.

Hofstede developed cultural dimensions to classify and evaluate cultural differences. Gray extended these cultural dimensions to accounting values. This enabled researchers to consider and identify relevant accounting values pertaining to specific accounting scenarios and environments.

Prior research by the authors focussed on accounting values pertaining to the adoption of International Financial Reporting Standards. The purpose of the study is to identify the relevant accounting values when a global set of accounting standards is implemented by the SME sector. Based on a sample consisting of final-year accounting students from two different universities in South Africa and one in the UK, our results suggest that contrasting accounting values are considered necessary when adopting a global set of accounting standards by the SME sector.

**JEL classification:** K2 - Regulation and Business Law (Other); L25 - Firm Performance: Size, Diversification, and Scope; M41 – Accounting.

**Key words:** Accounting, Cultural Backgrounds, Generally Accepted Accounting Practice, International Financial Reporting Standards, Small and Medium Entities.

## **1. Introduction**

The inconsistent accounting practices found in different parts of the world have historically fascinated accounting researchers over the years (Gujarathi, 2008:95; Lin & Wang, 2001:263; Mueller, 1965:386). A number of possible explanations for discrepancies in connection with accounting development, application and standard setting from different geographical areas of the world have been identified. One of these explanations is perhaps owing to the fact that accounting practices did not remain unchanged since its first application. The accounting practices described by Luca Pacioli were developed to address the reporting needs of Venetian merchants during the Italian Renaissance era (Edwards, 1989:52). Subsequent developments from different parts of the world required the discipline of accounting to adapt to additional reporting scenarios. Evidence of the influence of different levels of development on the accounting environment can also be found in recent times where developed countries find it easier to adopt International Financial Reporting Standards (IFRS) whereas developing countries find it more difficult to comply (United Nations, 2008:2).

Moreover, diverse accounting practices are not only attributable to different levels of development. Despite the fact that most of Europe consists of developed countries, individual member states of the European Union will move at different speeds to adopt IFRS (ACCA, 2004:1). Researchers therefore considered the influence of other environmental factors on the adoption and application of IFRS and the results often suggest that cultural differences are of significant influence (Garcia-Sordo & Baren, 1999:314; Perera, 1989:43).

Researchers have often focused on the cultural dimensions of Hofstede (1980:25) and the accounting values by Gray (1988:8) to evaluate cultural differences and its effect on the accounting environment. Various aspects within the accounting environment have been the subject of these studies, for example accounting students (Lindahl & Fanelli, 2002:285; Sullivan, 2006:1-13), accounting legislation and standard setting (Violet, 1983:2) and development of accounting practices (McKinnon, 1986:72-73). This study considered the impact of cultural differences between accounting students in South Africa and the United Kingdom (UK). The cultural dimensions of Hofstede (1980:25) were extended to the accounting values of Gray

(1988:8). Hofstede's cultural dimensions considered in this study were i) individualism versus collectivism that relates to the relationship between the individual and the group, ii) power distance that relates to social inequality in relation to authority, iii) masculinity versus femininity that relates to the social implications of being born as a male or a female and iv) uncertainty avoidance that relates to the ability to deal with uncertainty.

Following from the above Gray's accounting values considered were i) professionalism versus statutory control which refers to professional judgement and self regulation as opposed to compliance with prescriptive legal requirements and statutory control, ii) uniformity versus flexibility which refers to the enforcement of uniform and consistent accounting practices as opposed to flexibility in accordance with the perceived circumstances of individual companies, iii) conservatism versus optimism which refers to a cautious approach to accounting measurement as opposed to a more optimistic and risk-taking approach and iv) secrecy versus transparency which refers to confidentiality and the restriction of disclosure of information as opposed to a more transparent, open and publicly accountable approach.

## **2. Defining the research objective and hypothesis**

When the International Accounting Standards Board (IASB) announced the IFRS for SMEs to address the reporting requirements of small and medium entities (SMEs) additional research questions emerged. The cultural dimensions and related accounting values considered important for purposes of adopting IFRS are not necessarily also applicable to the SME sector. It is not only possible that the cost of compliance with IFRS by the SME sector outweigh the benefits, but the focus of SMEs is also not necessarily on international markets and trends. The main purpose of this article is therefore to identify the relevant cultural dimensions and related accounting values applicable to SMEs.

A key objective of the IFRS for SMEs was to develop a set of high quality, understandable and enforceable *global* standards for this sector (SAICA, 2007:4). When developing the IFRS for SMEs, the IASB considered transactions and conditions typically encountered by SMEs with approximately 50 employees (IASB, 2007:6). The adoption and successful implementation of a

global accounting standard for SMEs is however burdened by, amongst other possible factors, not only a lack of formalities but also the variety of definitions and different classification for SMEs by different countries. As a result the comparability of SMEs is not always possible.

Furthermore, cases of non-adherence to prevailing accounting standards were reported by Lin and Wang (2001:263) as well as Chari and Narasimhan (2001:1). We therefore suggest that, due to the informal nature of SMEs, adherence to a *global* set of accounting standards by SMEs would even be more burdensome and less likely. Based hereupon the following hypothesis can be formulated:

*H1:* The accounting values considered to be important in the process of adopting a prescriptive global set of accounting standards are different to the accounting values required to adopt the IFRS for SMEs.

To test the above hypothesis a survey based on Hofstede's (1980:25) cultural dimensions and Gray's (1988:8) accounting values were conducted amongst third year accounting students at the Mafikeng and Potchefstroom campuses of the North West University in South Africa as well as the De Montford University in the UK. The inclusion of these institutions enabled us to consider cultural differences between countries as well as cultural differences within a particular country. The decision to include accounting students was also based on the facts that i) they were expected to be one of the first groups of students to enter the working environment who were exposed to IFRS education and training<sup>7</sup>, ii) they were not influenced by prior national and other non-IFRS accounting standards, practices and experiences and iii) they were generally from the same age group thus eliminating as much as possible potential 'noise' created from different age groups.

The remainder of the article is structured as follows: Section three describes the general

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<sup>7</sup> According to Gannon and Ashwal (2004:43) companies were required to implement IFRS as from 1 January 2005. The accounting students included in the study commenced their studies at approximately the same time.

theoretical framework and covers the relevant literature review, sections four and five present the appropriate sections, results and discussion from our study in connection with the cultural dimensions of accounting students in South Africa and the UK; while the study concludes with the conclusion in section six.

### **3. Theoretical framework**

#### *3.1. Defining small and medium entities*

SMEs are the backbone of most national economies, representing between 30 and 60 percent of the gross domestic product (Johannson, 2005:9). Furthermore, SMEs often account for 95 percent of entities and 60 to 70 percent of employment in most economies (Ministry of Economic Development, 2005). However, Frempong (2007:5) concluded that data on SMEs is often unreliable primarily because there is no central public database for SMEs available. Frempong (2007:5) also emphasised the importance of defining SMEs in order to determine the economical impact of SMEs. This leads to the question of what are the organisational requirements to be considered an SME.

Etemad (2004:1) defined Canadian SMEs as businesses with fewer than 500 employees and less than CDN\$50 million in annual revenues. In Kenya and Italy SMEs are defined as entities with less than 50 employees (ACCA, 2000; Koh & Chang, 2005:384). Statistics Canada defines an SME as an entity having less than 100 employees (Johannson, 2005:3). In Singapore SMEs are defined as entities with less than 200 employees (CCS, 2006:2). SMEs in the UK are defined as entities with less than 250 employees (INECE, 2008:145), in Japan SMEs are defined as entities with no more than 300 employees (Evans, 1999:1) and in the USA SMEs are defined as entities with less than 500 employees (Beyene, 2002:133). The definition of SMEs according to the European Commission recommendation 2003/361/EC is based on the number of employees which is as follows (OECD, 2004:11):

- Micro enterprises/entities: Less than ten employees.
- Small enterprises: Less than 50 employees.

- Medium enterprises: Less than 250 employees.

Furthermore, the Organisation for Economic Co-operation and Development admitted that very different practices are used across countries and over time to define SMEs (OECD, 2004:10). Some countries tend not to make a distinction between legal and statistical definitions, for example Greece, Portugal, Mexico and the Slovak Republic. The definition can be based on a threshold in revenue, it can be based on the number of employees or it can combine the number of employees and turnover for legal and statistical purposes. Although there is no universally accepted definition of SMEs in Africa (Beyene, 2002:133), the private sector consists of mostly informal micro-entities, operating alongside large firms (Kauffmann, 2005:2). In the Congo 83 percent of entities are in the informal sector and approximately 80 percent of all entities have fewer than five workers (Kauffmann, 2005:5). Due to the very small nature of SMEs in Africa (often less than 5 employees), a typical SME in the USA (with a maximum of 499 employees) might therefore be classified as a large entity in the African context (Beyene, 2002:133). In South Africa the definition of an SME is based on a combination of revenue, number of employees as well as total gross asset values. Moreover, the classification of an SME in the South African context is dependent on various business sectors, for example agriculture, manufacturing and construction (National Small Business Amendment Act, 26/2003).

None of the above definitions was necessarily the intended group of entities envisaged by the IASB in developing the IFRS for SMEs. Instead the exposure draft might have been intended for use by small and medium-sized entities that i) do not have public accountability and ii) do not publish general purpose financial statements for external users (IASB, 2007:15). In 2006 the German Accounting Standards Board (GASB) commented to the IASB that the intended group would comprise entities of different legal forms and entities of very different sizes (GASB, 2006:1). In deciding on the content of the proposed IFRS for SMEs, the IASB focused on the types of transactions and conditions typically encountered by SMEs with approximately 50 employees (IASB, 2007:6). In Germany, however, the IFRS for SMEs could be too burdensome for certain companies with less than 50 employees (GASB, 2006:1).

Even though the IASB (2007:13) concluded that the final decision on which entities are to apply IFRS for SMEs rests with national regulatory authorities and standard-setters, we suggest that the

adoption of a global set of accounting standards for SMEs would be problematic due to the various definitions and classifications of SMEs by different countries.

### *3.2. The absence of formality*

A key characteristic of SMEs is listed as a lack of formality in terms of business licenses, tax registration, formal businesses premises and accounting procedures (White Paper, 1995:11). The American Heritage Dictionary of the English Language (2000:494) defines the term *formality* as a rigorous or ceremonious adherence to established norms, rules, or customs. Frempong (2007:7-8) emphasised the importance of distinguishing between formal and informal entities when he developed a formality index for African SMEs. His formality index is based upon i) form of ownership, ii) registration for income tax and VAT, iii) whether a business uses written employment contracts, and iv) separation of business and personal finances and bookkeeping.

According to Stanworth and Curran (1976:95) SMEs are entirely different social and economic entities than larger organisations. McKiernan and Morris (1994:32) list the central role of the owner (CEO) as his/her multiplicity of duties and close identity with employees, inherent flexibility/mobility, marriage of ownership/control, and nepotism/inter-family rivalry as unique SME attributes. They also argue that the imposition of formality, no matter how flexible, is incongruous with the dominant culture of SMEs and that formal mechanisms may restrict entrepreneurial flair. It is therefore evident that, based on the definition by the American Heritage Dictionary of the English Language (2000:494), SMEs do not formally adhere to, or follow rigorous ceremonies and processes relating to accounting procedures (White Paper, 1995:11) and bookkeeping (Frempong, 2007:7-8).

### *3.3. Reporting framework for SMEs*

Notwithstanding reports in connection with discrepancies relating to the implementation of global accounting standards by large/corporate companies, the IASB published an Exposure Draft on IFRS for SMEs in 2007. The proposed IFRS for SMEs' reporting framework is expected to be easier to apply in practice and should provide relief from many of the historic GAAP disclosure requirements (Temkin, 2007:1). The feasibility of a global set of accounting

standards for the SME sector is however uncertain as the traditional focus of SMEs is on local markets/environments with limited exposure to international investors and other users of SME financial statements (Johnson & Turner, 2003:128). The local markets and specific environments in which SMEs operate should therefore be considered prior to the adoption of a global set of accounting standards for SMEs. Furthermore, due to the fact that culture is considered to be the most important environmental factor (Perera, 1989:43) we suggest that the SME sector is particularly vulnerable to and affected by cultural differences. The adoption of a single global set of accounting standards for the SME sector in different countries might therefore be easier said than done (Chen, Sun & Wang, 2002:183; Fisher, 2005:66).

#### **4. The impact of cultural differences on accounting students**

##### *4.1. Hofstede's cultural dimensions*

Our research utilised the 1994 Value Survey Model of Hofstede to evaluate cultural differences of accounting students with traditionally different cultural backgrounds. Two campuses from the North West University in South Africa were included in the sample, the Potchefstroom Campus (PTC) with predominantly white students and the Mafikeng Campus (MFK) with predominantly black students from historically disadvantaged backgrounds. In addition to accounting students from the North West University we have also included accounting students from the De Montfort University (DMU) in the United Kingdom. Our evaluation revealed a distinct pattern between cultural backgrounds of accounting students and the extent to which certain cultural dimensions are favoured by them. The cultural dimensions of accounting students at MFK and PTC in South Africa and the DMU in the United Kingdom are set out in table 1 below after which the sample statistics and frequency of responses is presented in table 2.

**Table 1 – Index rating: Cultural dimensions of accounting students**

	<u>De Montford</u> <u>(DMU)- UK</u>	<u>Potchefstroom</u> <u>(PTC) – SA</u>	<u>Mafikeng</u> <u>(MFK) - SA</u>
Individualism (IDV)	78.91	77.46	59.51
Power Distance (PDI)	11.68	20.97	24.89
Masculinity vs Femininity (MAS)	21.09	53.22	14.95
Uncertainty Avoidance (UAI)	59.95	69.07	88.57

**Table 2 - Sample Statistics and Frequency of Responses**

	<i>Campus</i>	DMU (n=92)	PTC (n=118)	MFK (n=91)	Total (n=301)		<i>Campus</i>	DMU (n=92)	PTC (n=118)	MFK (n=91)	Total (n=301)
Q1	$\mu$	1.750	1.695	2.055	1.821	Q11	$\mu$	2.054	1.788	1.835	1.884
	$\sigma$	0.897	0.891	1.047	0.953		$\sigma$	0.843	0.761	0.992	0.866
	<i>Std. Error</i>	0.093	0.082	0.110	0.055		<i>Std. Error</i>	0.088	0.070	0.104	0.050
Q2	$\mu$	1.794	1.653	1.703	1.711	Q12	$\mu$	2.207	2.195	2.473	2.282
	$\sigma$	0.792	0.881	0.937	0.872		$\sigma$	0.989	0.972	1.068	1.012
	<i>Std. Error</i>	0.083	0.081	0.098	0.050		<i>Std. Error</i>	0.103	0.090	0.112	0.058
Q3	$\mu$	1.783	1.839	1.659	1.767	Q13	$\mu$	2.630	2.839	2.868	2.784
	$\sigma$	0.708	0.915	0.846	0.836		$\sigma$	0.911	0.795	0.636	0.794
	<i>Std. Error</i>	0.074	0.084	0.089	0.048		<i>Std. Error</i>	0.095	0.073	0.067	0.046
Q4	$\mu$	1.576	1.653	1.571	1.605	Q14	$\mu$	3.152	3.212	3.286	3.216
	$\sigma$	0.759	0.900	0.956	0.876		$\sigma$	0.864	0.904	1.003	0.922
	<i>Std. Error</i>	0.079	0.083	0.100	0.051		<i>Std. Error</i>	0.090	0.083	0.105	0.053
Q5	$\mu$	1.761	1.788	1.637	1.734	Q15	$\mu$	3.163	3.441	3.846	3.478
	$\sigma$	0.732	0.932	0.837	0.846		$\sigma$	0.987	0.882	0.930	0.965
	<i>Std. Error</i>	0.076	0.086	0.088	0.049		<i>Std. Error</i>	0.103	0.081	0.098	0.056
Q6	$\mu$	2.120	2.212	2.209	2.183	Q16	$\mu$	3.033	3.136	3.451	3.199
	$\sigma$	0.862	0.856	0.863	0.858		$\sigma$	1.063	0.969	1.195	1.080
	<i>Std. Error</i>	0.090	0.079	0.091	0.050		<i>Std. Error</i>	0.111	0.089	0.125	0.062
Q7	$\mu$	1.511	1.534	1.626	1.555	Q17	$\mu$	2.946	2.619	2.824	2.781
	$\sigma$	0.687	0.844	1.007	0.853		$\sigma$	0.918	1.053	1.198	1.067
	<i>Std. Error</i>	0.071	0.078	0.106	0.049		<i>Std. Error</i>	0.096	0.097	0.126	0.062
Q8	$\mu$	1.957	2.017	2.011	1.997	Q18	$\mu$	2.826	2.932	2.714	2.834
	$\sigma$	0.901	0.887	1.038	0.936		$\sigma$	1.075	0.985	1.259	1.101
	<i>Std. Error</i>	0.094	0.082	0.109	0.054		<i>Std. Error</i>	0.112	0.091	0.132	0.064
Q9	$\mu$	1.707	1.585	1.747	1.671	Q19	$\mu$	3.011	2.534	2.429	2.648
	$\sigma$	0.871	0.880	1.060	0.935		$\sigma$	1.084	1.027	1.222	1.129
	<i>Std. Error</i>	0.091	0.081	0.111	0.054		<i>Std. Error</i>	0.113	0.095	0.128	0.065
Q10	$\mu$	2.337	2.119	2.429	2.279	Q20	$\mu$	3.109	2.746	3.253	3.010
	$\sigma$	0.829	0.730	0.921	0.830		$\sigma$	1.172	1.031	1.270	1.168
	<i>Std. Error</i>	0.086	0.067	0.097	0.048		<i>Std. Error</i>	0.122	0.095	0.133	0.067

#### 4.2. *Gray's accounting values*

Gray (1988:5-8) suggested that accounting values are derived from cultural dimensions and that these accounting values, in turn, influence accounting systems. Gray also identified an interaction between his accounting values and the cultural dimensions of Hofstede. This interaction resulted in the following hypotheses (Gray, 1988:8-11):

- The higher a group ranks in terms of *individualism* and the lower it ranks in terms of *uncertainty avoidance* and *power distance*, the more likely it is to rank highly in terms of *professionalism*.
- The higher a group ranks in terms of *uncertainty avoidance* and *power distance* and the lower it ranks in terms of *individualism* then the more likely it is to rank highly in terms of *uniformity*.
- The higher a group ranks in terms of *uncertainty avoidance* and the lower it ranks in terms of *individualism* and *masculinity* then the more likely it is to rank highly in terms of *conservatism*.
- The higher a group ranks in terms of *uncertainty avoidance* and *power distance* and the lower it ranks in terms of *individualism* and *masculinity* then the more likely it is to rank highly in terms of *secrecy*.

#### 4.3. *Application of accounting values to global reporting standards*

In order to implement a *prescriptive* global set of accounting standards we suggest that the following accounting values of Gray should be present:

- *Statutory control* in order to adhere to a single set of prescribed rules and regulations in connection with accounting transactions and related disclosure thereof;
- *Uniformity* in order to, irrespective of different backgrounds, apply uniform accounting practices and principles; and
- *Transparency* in order to be open and publicly accountable.

The adoption of a *prescriptive* global set of accounting standards is further complicated by the fact that IFRS is principles-based as opposed to rules-based, implying that the following

accounting values are important:

- *Professionalism* in order to apply professional judgment to specific scenarios;
- *Flexibility* in order to adapt to individual situations and specific scenarios; and
- *Transparency* for purposes of public accountability.

#### 4.4. Application of accounting values to the SME sector

We suggested that *statutory control* is the first accounting value required to adopt a global set of accounting standards. We based our conclusion on the fact that adherence to standardised accounting practices by accountants with various backgrounds will require prescriptive rules and regulations to account for a wide range of transactions. If the SME sector is added to the equation alternative accounting values might be of relevance. Legislation is not always designed to address the specific needs of the SME sector. Singh, Garg and Deshmukh (2010: 56) listed unsupportive legislation as one of the major obstacles of the SME sector. Schmidt, Bennison, Bainbridge and Hallsworth (2006: 257) argued that compliance with legislation is regarded by the SME sector as a technical matter and suggested that imposed legislation often results in negative perceptions by SME owners. Research by Munnich (2004: 3) revealed that SMEs have limited capacity to attend to legislation; as a consequence the cost of SMEs to comply with legislation is nearly six times higher than large companies. Munnich (2004: 9) also suggested that regulation reduces innovation and job creation and generally discourages entrepreneurship by SME owners. McKiernan and Morris (1994: 32) also argued that formal mechanisms may restrict the entrepreneurial flair of SMEs. The evidence therefore suggests that compliance with prescriptive legal requirements (or *statutory control*) is not an SME attribute and that *professionalism* prevail.

The second accounting value identified was *uniformity*. The opposite accounting value, *flexibility* or mobility is however listed as a key concomitant of the SME sector (McAdam 2000: 320; McKiernan and Morris 1994: 32). Hale and Cragg (1996: 16) declared that SMEs have a natural degree of *flexibility* and change orientation because of their closeness to customers and a lack of organisational bureaucracy. Pinho (2007: 728) observed that SMEs would prefer to retain *flexibility* when making business decisions. Moreover, according to Chen (2006: 145) the unique

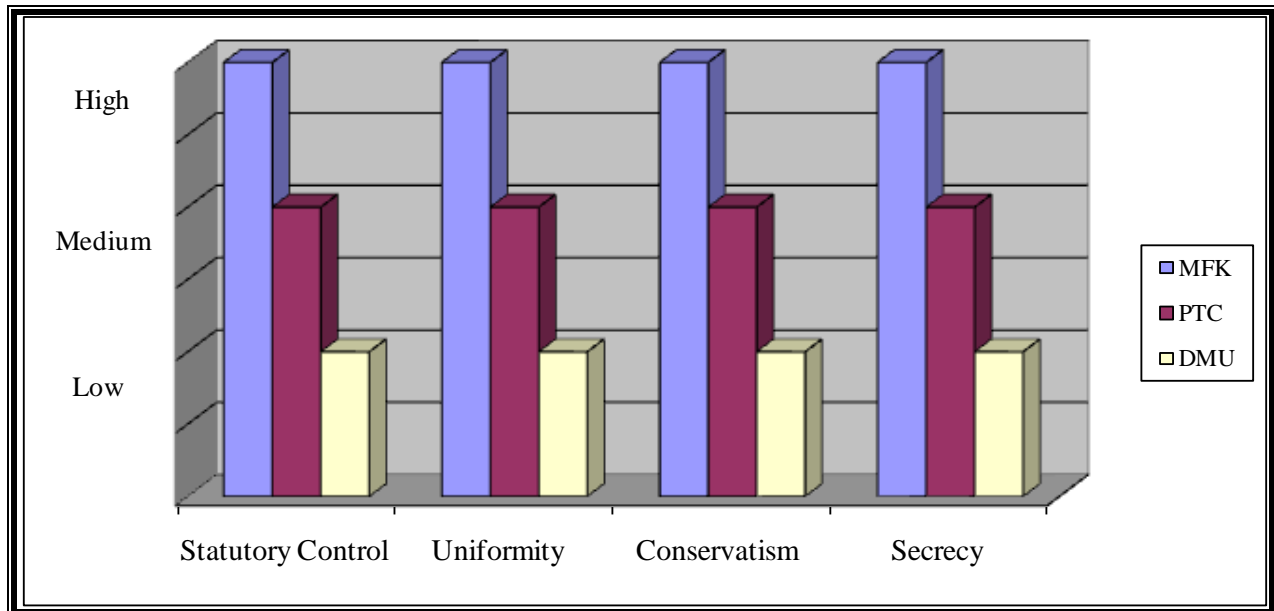
nature of SMEs is comprised of small investments, fast yields, flexible operation and the ability to swiftly adapt to market changes. We therefore suggest that *uniformity* is also not an SME attribute.

Thirdly *transparency* was considered to be a prerequisite for the successful adoption of a global set of accounting standards. Edwards and Turnbull (1994: 7) suggested however that a culture of *secrecy* is often experienced by researchers when analysing financial data of SMEs. The study of Fahed-Sreih (2009: 54) was also complicated by confidentiality and *secrecy* issues when analysing revenue generated by the SME sector. Moreover, the fact that SME financial statements are only available to a limited user audience (SAICA 2000: 4) implies that SMEs would opt for *secrecy* or a preference for confidentiality. It is therefore evident that the third and final accounting value is also not applicable to the SME sector.

#### *4.5. Classification of accounting values per institution*

Based on the above hypotheses by Gray and the aforementioned discussion the classification of accounting values of the accounting students included in the survey is presented in figure 1:

**Figure 1 – Classification of accounting values**



## 5. Discussion

The cultural dimensions in table 1 revealed an almost perfect linear order between the three institutions included in our study (except for *masculinity*). DMU and MFK obtained highest/lowest scores for three out of the four cultural dimensions with PTC in between. Due to the fact that Gray (1988: 11) suggested that *masculinity* is of lesser importance it was possible to convert the cultural dimensions of Hofstede in table 1 into the accounting values of Gray in figure 1.

The results in figure 1 revealed that two of the three accounting values considered to be important when adopting *prescriptive* global accounting standards were favoured by MFK, namely *statutory control* and *uniformity*. The adoption of a *prescriptive* global set of accounting standards is however complicated by the fact that IFRS is principles-based as opposed to *prescriptive* rules. The results in figure 1 suggest that none of these accounting values were favoured at MFK and that the application of principles, as opposed to rigid rules, is more acceptable to students at DMU. The adoption of a *prescriptive* global set of accounting standards is however not only complicated by the impact of principles and other factors might also play a

role when a one size fits all set of accounting standards is adopted.

Where the SME sector is concerned the results in figure 1 revealed that two out of three accounting values considered relevant to SMEs were present at DMU, namely *professionalism* and *flexibility*.

## 6. Conclusion

In conclusion, the study proposes that South African accounting students have the majority of the accounting value attributes (*statutory control* and *uniformity*) considered necessary to adopt a global set of accounting standards. Based on these accounting values the institutions included in the study were classified in order of importance as: MFK (SA), PTC (SA) and DMU (UK).

If the unique nature of the SME sector is considered a different set of accounting values are considered to be important. The hypothesis is therefore not rejected due to the outwardly perfect negative relation between the accounting values required to be important when adopting a global set of accounting standards (*statutory control, uniformity* and *transparency*) and the accounting values identified for the SME sector (*professionalism, flexibility* and *secrecy*). Our research suggests that the accounting students from the UK are better equipped to deal with the unique nature of SMEs due to a preference for *professionalism* and *flexibility* at DMU. Where SME-attributes are concerned the institutions included in the study should therefore be classified in the order: 1<sup>st</sup> DMU (UK); 2<sup>nd</sup> PTC (SA) and 3<sup>rd</sup> MFK (SA). Although it appears as if South African students, and more specifically MFK students, are better equipped to adopt a global set of accounting standards and that UK students are better equipped to identify with the unique nature of SMEs, we recommend that educators, practitioners and standard setters should consider the contrasting emphasis when applying IFRS principles to the SME sector.

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INECE *see* International Network for Environmental Compliance and Enforcement.

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## **Annexure A – Guide for authors (Journal of Social Sciences)**

**SUBMISSION OF MANUSCRIPT:** For the initial submission of manuscripts for consideration, submit a hardcopy with disk to the Administrative Editor, B-2 (Ground Floor), South City II, Gurgaon 122 018, Haryana, India or e-mail to: kre@airtelmail.in. Prepare the manuscript as per style of the Journal. Manuscripts, which do not fully confirm to Journal style, will be returned to the Authors.

**FORMALITIES:** The contributors may send the papers to the Administrative Editor. The paper will be screened only (not reviewed) by the Members of the Editorial Board for its suitability to be considered for publication and If it is observed suitable than the Corresponding Author is asked to complete the initial formalities as follow:

- 1) **Review of Paper:** The contributors may provide the names of at least three Referees in the field of specialisation as the subject of the paper demands, to whom we may request for review of the paper (Please provide separate List of Referees for each paper) The Referees should be other than the Members of Editorial Board of the Journal, who are known to you and aware of the research activities of your Department/Institute, but are not from yours' Department/Institute (Please provide their postal & e-mail address and field of specialisation). The possible exceptions are in the case of occasional invited papers and editorials, or where a partial or entire volume is devoted to a special theme.
- 2) **ACCEPTED PAPER:** After final acceptance, the disk along with the final and exactly matching printed versions with the underlining clearly marked should be submitted or e-mail the text to kre@airtelmail.in. Acceptance of paper will be acknowledged via e-mail.
- 3) **SIZE:** An article should not generally exceed twelve printed pages (18 double spaced typed pages of MS Word). The authors would be charged for additional pages, even if a longer article is accepted for publication. Reporting of frequency data may be accepted in the form of small report. Such reports should generally not exceed four pages, including tables/figures.
- 4) **TITLE:** The paper title, author's name, affiliation, complete address, Fax number, and e-mail address should appear on the first page of the article. When there is more than one author, the correspondence will be sent to the first author, unless otherwise requested.
- 5) **RUNNING HEAD:** Not more than 40 characters (including spaces) should be identified on the title page.
- 6) **ABSTRACT:** Not exceeding 250 words.

7) KEYWORDS: Not exceeding six should accompany the manuscript.

8) TABLE: Each table should be typed separately and marked in the text in numerical order.

9) ILLUSTRATION: It should be clear, concise, and good for reproduction (maximum size for illustrations is 120 x 180 mm/ 80x160mm). All illustrations are referred to as Figures.

10) REFERENCES: These should be listed at the end of article, arranged alphabetically according to the surnames of the authors and then chronologically. Following are examples of the proper reference style of various sources:

- Journals:

Bhasin V 1996. Caste dynamics in transhumant society. *J Hum Ecol*, 7(2): 77-94.

- Books:

Bhasin MK, Bhasin Veena 1995. *Sikkim Himalayas: Ecology and Resource Development*. Delhi: Kamla-Raj Enterprises.

- Sections of Books:

Cohen CP 1998. United Nations convention on rights of the child: relevance for indigenous children. In: DK Bhera (Ed.): *Children and Childhood in Contemporary Societies*. Delhi: Kamla-Raj Enterprises, pp. 173-187.

- Thesis / Dissertation:

Bhasin Veena 1981. *Ecological Influence on the Socio cultural System of the Gaddis of Bharmour Sub-Tehsil, Chamba District, Himachal Pradesh*. Ph. D. Thesis, Unpublished. Delhi: University of Delhi.

- Website:

Official Home Page of Work and Income New Zealand. Retrieved March 18, 2004, from <http://www.workandincome.govt.nz>

11) When there are more than five authors use et al. in place of rest of the authors.

## CHAPTER 5 (Article 4)

### ***Title: A critical analysis of the contents of the IFRS for SMEs - A South African perspective***<sup>8</sup>

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<sup>8</sup> The reader should take note of the following:

The article has been co-authored with the study promoter and accepted for publication by the following peer reviewed ISI indexed and Department of Education accredited journal as:

Schutte, D.P. and Buys, P.W. 2010. A critical analysis of the contents of the IFRS for SMEs - A South African perspective. *South African Journal of Economic and Management Sciences* (forthcoming) (ISSN1015-8812)

The article was researched and written by the first author as the candidate. The 2<sup>nd</sup> author fulfilled a 'reviewer' function thereto as the study promoter. Estimated weightings of contribution are as follows:

- Schutte, D.P. (85%)
- Buys, P.W. (15%)

## **Abstract**

The IFRS for SMEs was developed to address the reporting needs of SMEs worldwide. SMEs however do not necessarily have a global focus. Furthermore, SMEs from different parts of the world are exposed to different conditions and environments.

Although the IFRS for SMEs was not intended for a specific user group, the majority of the respondents to the Exposure Draft on IFRS for SMEs were from Europe and other developed countries while only limited respondents from Africa and developing countries were involved.

This study considered the relevance of the contents of the IFRS for SMEs in the South African environment based on user requirements. Since SMEs do not necessarily have functional accounting departments and because they rely on external accountants to compile financial statements we included accounting practitioners and trainee accountants from the SME sector in our survey. As a result we classified the contents of the IFRS for SMEs as highly important, moderately important and less important.

**JEL classification:** L25 - Firm Performance: Size, Diversification, and Scope; M40 – General; M41 – Accounting; M48 – Government Policy and Regulation.

**Key words:** Accounting, General Accepted Accounting Practice, International Financial Reporting Standards, Small and Medium Entities.

## 1. Introduction

Proper and relevant disclosure of financial information has been called for by a number of observers in recent times. According to Wömpener and Köhrmann (2006:2) appropriate reporting of financial measures not only facilitates company performance appraisal, but also enhances transparency. In addition, the adoption of International Financial Reporting Standards (IFRS) is intended to facilitate cross-border investments and access to global capital markets (AICPA, 2008:2). Since many public companies are required to apply IFRS for stock-exchange listing purposes, the adoption of IFRS became a necessity for international business. As a result IFRS was adopted by many *listed* companies in Europe and elsewhere (ICAS, 2008:1).

A different scenario, however, prevails to *non-listed* and/or small and medium entities (SMEs). Dixon, Thompson and McAllister (2002:27) argued that matters pertaining to large firms are not necessarily applicable to SMEs. In 1995 the American Institute of Certified Public Accountants (AICPA) rated certain generally accepted accounting principles (GAAP) requirements, from the perspective of SMEs, as low on decision, relevance and usefulness (Zanzig & Flesher, 2006:4). In addition, the emphasis on global financial reporting standards due to international harmonisation and business might not be a priority for SMEs because only a small percentage of the SME sector has a global focus. Van Mourik (2007:193) concluded that globalisation and internationalisation are products of multinational companies. According to the Organisation for Economic Co-operation and Development (OECD) approximately one per cent of SMEs can be considered as global companies. SMEs involvement in globalisation is often limited to those that engage in some form of exporting to economies that are geographically close to each other and culturally similar (OECD, 1997:89). It is therefore suggested that the accounting and related disclosure functions of SMEs are limited to transactions encountered by SMEs in individual countries.

Nonetheless, the International Accounting Standards Board (IASB) developed a global accounting standard for use by the SME sector. In developing the IFRS for SMEs, one of the objectives was to develop, in the public interest, a single set of high quality, understandable and enforceable *global* accounting standard for the SME sector. The IASB (2007:11) was committed

to take into account the special needs of SMEs and in deciding the content of the proposed IFRS for SMEs, the IASB focused on the types of transactions and other events and conditions typically encountered by SMEs with approximately 50 employees (IASB, 2007:6). SMEs worldwide do however not necessarily engage in similar activities; SMEs in the UK are mainly involved in the agricultural, business and construction sectors; South African SMEs are prominent in community, social and personal services and the finance, real estate, wholesale and agriculture sectors; and in Kenya SMEs are mainly involved in agricultural activities (ACCA, 2000:1-4). Due to these differences it is suggested that the different conditions and transactions encountered by different countries are not conducive to a global set of accounting standards for the SME sector. Accordingly, in order to assess the relevance of the IFRS for SMEs, the contents of the proposed IFRS for SMEs should be compared to transactions and events disclosed by SMEs from different countries.

## **2. Theoretical framework**

### *2.1. Development of an accounting reporting standard for SMEs*

The debate around Big GAAP and Small GAAP<sup>9</sup> has been an ongoing issue since the 1800s. In 1886 the Senate Select Committee in Interstate Commerce based in the United States (US) considered the question whether corporations should be required to adopt a uniform system of accounts (Ho & Shying, 2007:1). Since then a number of commentators supported such a uniform set of accounts for reasons of comparability, while commentators opposing uniformity based their arguments on the fact that the benefits derived from information should exceed the cost of providing it. In 1995 the Private Company Financial Reporting Task Force of the AICPA concluded that the benefits for SMEs in complying with GAAP outweigh the costs (Zanzig & Flesher, 2006:4). Elsewhere, many national standard-setters have introduced differential reporting for SMEs, resulting in diverse practices by standard-setters, preparers and users of

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<sup>9</sup> Generally accepted accounting practices/principles applicable to large (Big GAAP) and small (Small GAAP) entities.

SME financial statements (Cordery & Baskerville, 2006:2).

The development of a global, uniform set of financial reporting standards for SMEs commenced in 2004 when the IASB published a discussion paper on the preliminary views on financial reporting standards for SMEs. In 2007 the IASB published a document for public comment entitled “The Exposure Draft (ED) of International Financial Reporting Standard for Small and Medium-sized Entities” (IFRS for SMEs) which incorporated approximately 15% of the reporting standards applicable to large and listed entities (SAICA, 2007a:2). Approximately five years after the initial discussion paper the IASB formally adopted the ED on IFRS for SMEs as an International Financial Reporting Standard (IASB, 2009a:1). The IFRS for SMEs was therefore a result of a five-year development process during which the IASB considered 162 letters of comment on the ED (IASB, 2009b:1).

In 2004 the Hong Kong Institute of Certified Public Accountants expressed their concern with the IASB’s preliminary views on accounting standards for SMEs and suggested that the IASB should conduct a survey to ascertain to what extent the accounting standards for SMEs would result in compliance cost saving for SMEs (HKICPA, 2004:1).

The European Accounting Association’s Financial Reporting Standards Committee commented that the financial reporting regulations of the IASB are influenced by the user needs of a traditionally Anglo-American corporate governance tradition, and, since the Continental model<sup>10</sup> apply to most of Europe, the IFRS for SMEs will not address the reporting needs of SMEs in Europe (EAAFRSC, 2004:20; Joos & Lang, 1994; Zeghal & Mhedhbi, 2006).

The Association of Finnish Accounting Firms (2007:1) commented to the IASB that the ED on IFRS for SMEs had a very strong focus on the needs of capital markets and investors and that the needs of small unlisted companies were ignored. They concluded that, because the ED on IFRS for SMEs was mere a scaled-down version of IFRS for listed companies, its focus was still too much on the IFRS for listed companies, and therefore still too complex. The Institute of

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<sup>10</sup> Refer to Joos and Lang (1994) in connection with the Anglo-Saxon and Continental accounting philosophy models. Zeghal and Mhedhbi (2006) suggested that countries with Anglo-American cultural backgrounds are more likely to adopt IFRS.

Chartered Accountants in Australia (2007:1) also commented to the IASB that the ED on IFRS for SMEs is too complicated for SMEs in the Australian context. In addition the Institute of Chartered Accountants in Australia (2007:1) concluded that the recognition, measurement and disclosure needs of the key stakeholders of SMEs were not taken into consideration by the IASB. The following additional points were revealed by RSM International (2008:22-30) in connection with the comments received by the IASB:

- The European Union (EU) commented that the ED was not applicable for the bulk of SMEs in the EU;
- The Institute of Chartered Financial Analysts commented that the proposed IFRS for SMEs would create non-comparable information;
- The Italian Organismo Italiano di Contabilita and The Hundred Group of Finance Directors suggested that fair value accounting is not applicable to SMEs;
- The Accounting Standard Board of the UK commented that the ED is only applicable to larger companies in the SME sector;
- More simplifications were called for by, among others, The Mouvement des Entreprises de France and ICAC (Spain); and
- The Dutch Accounting Standards Board commented that the ED did not address the needs of the users of SME financial statements.

On 7 August 2007, in the midst of the aforementioned development process, South Africa became the first country in the world to formally adopt the IASB's ED on IFRS for SMEs, without any changes to the ED's original text, as the Statement of GAAP for SMEs (Carte, 2007:1). However, two months after the adoption of the ED on IFRS for SMEs the South African Institute of Chartered Accountants commented to the IASB that: i) significant simplifications are needed, ii) the scope should be more clearly defined and iii) the requirements in the proposed IFRS for SMEs are too onerous given the level of accounting knowledge of preparers and the needs of the users of the financial statements (SAICA, 2007b). The comments by the South African Institute of Chartered Accountants could be indicative of the fact that the adoption of the ED on IFRS for SMEs in the South African context was premature. The possibility that the ED

on IFRS for SMEs was implemented too early in the South African context was further supported when the South African Institute of Chartered Accountants suggested, in addition to IFRS and IFRS for SMEs, a third level of reporting for non-public interest entities (SAICA, 2008:1) which resulted in the commissioning of a South African working group to draft a proposed financial reporting framework for non public entities and to address the concerns that were raised against the IFRS for SMEs (Lombard, 2008:20; SAIPA, 2009:1).

## *2.2. Users of SME financial statements*

The main purpose of financial statements is to address the needs of the users thereof (FERF, 2006:4). Although the IFRS for SMEs was not developed for a specific group of users (Lombard, 2008:19), the IASB acknowledged a wide range of users of SME financial statements as well as distinct information requirements when compared to users of conventional IFRS financial statements (IASB, 2009c:18). The extent to which the IFRS for SMEs will address the information needs of all the user groups of SME financial statements remains however uncertain. Anacoreta and Silva (2005:17) could not identify statistically significant patterns from the responses received in connection with the IASB's preliminary views on international accounting standards for small and medium-size entities. This led them to conclude that the significant intrinsic issues of the IASB questions are not distinctive enough to shape a pattern of answers or group of respondents. In response to the ED on IFRS for SMEs the European Accounting Association's Financial Reporting Standards Committee suggested that user groups of large public-interest enterprises and SMEs are not the same and advocated that user groups may even differ between larger SMEs and smaller SMEs (EAAFRSC, 2008:29). Deaconu, Nistor and Popa (2009:8) examined SME stakeholders' needs and their inference upon SME financial reports. Their research contained the following main user groups of SME financial statements:

- Public or tax authorities;
- Financial creditors (banks);
- Shareholders; and
- Managers.

Although tax authorities are key recipients of SME financial statements (Sian & Roberts, 2009:302) accounting standards are, due to different tax jurisdictions worldwide, not intended to meet the reporting needs of tax authorities in different countries (IFAC, 2006:17; IASB, 2009c:20). Apart from tax authorities, the most frequent users of small company financial reports include owner-managers and providers of finance (Saracina, 2005:2). Providers of finance include banking institutions and investors while internal users of financial statements are mainly concerned with the management of businesses. According to the European Commission (2010:8) financial statements constitute only one of many factors that are considered in the credit granting process by banking institutions. The European Commission (2010:8) concluded that the adoption of the IFRS for SMEs, if compared to prevailing national accounting practices, will not provide additional benefits to banks. Moreover, banks usually do not depend on published financial statements since they have the right and/or power to demand the information they require (EAAFRSC, 2008:37). While bankers require financial statements for accuracy and comparability purposes and since investors consider trend lines and year-over-year comparisons to be important, relatively little is known about the actual views and needs of owner-managers (EAAFRSC, 2004:2). Schiebel (2008:1) concluded that the ED on IFRS for SMEs is biased towards the opinions of auditors and accountants, implying that the views of internal users of SME financial statements were not considered by the IASB. Even though Saracina (2005:2) listed owner-managers as frequent users of SME financial statements, Sian and Roberts (2009:289, 301) concluded that SME owners have limited or no formal accounting training, they rely on external accountants to prepare their financial statements and accordingly they are often left bewildered by the complexity of the information provided. In addition, Sian and Roberts (2009:301) concluded that SME owners utilise computerised accounting programs, and not the financial statements, to interpret data for managerial purposes. The omission of the views of owner-managers, as internal users of financial statements, was also confirmed by the IASB's (2009c:20) statement that it is not the purpose of the IFRS for SMEs to provide information to owner-managers to help them make management decisions.

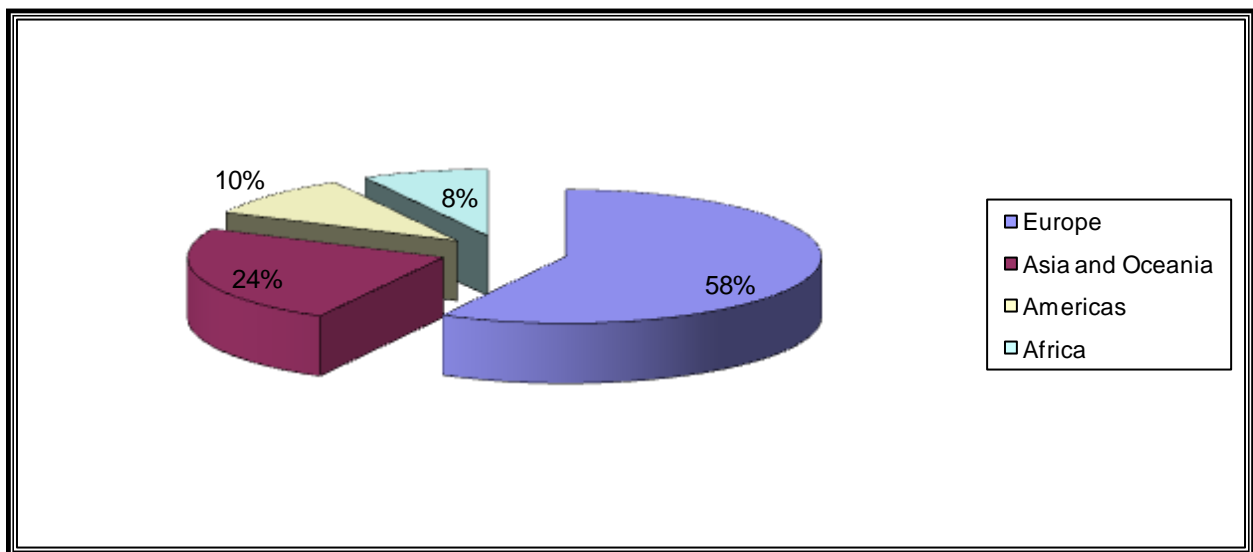
The evidence therefore suggests that the views of internal users of SME financial statements were omitted due to no formal accounting training as well as limited interest by this group of users due to no reliance on financial statements for managerial purposes. Furthermore, as far as

external users are concerned, Schiebel (2007:17) reported that only 8% of respondents to the ED on IFRS for SMEs were external users of SME financial statements. Accordingly, even though the IFRS for SMEs is intended for non-publicly accountable entities that publish general purpose financial statements for external users, the benefits of the IFRS for SMEs for the different user groups remain to be tested.

### 2.3. Worldwide empirical analysis

In respect of global research, Schiebel (2007:17) concluded that the IASB did not conduct serious worldwide empirical analyses in deciding the contents of the ED on IFRS for SMEs. The summary of responses to the ED on IFRS for SMEs in annexure A suggests that the majority of responses was received from the UK. Furthermore, if the responses are grouped per continent it is evident that 58% of the responses was from Europe alone (refer to figure 1 below).

**Figure 1 – Responses to ED on IFRS for SMEs per continent**



Even though the majority of the responses to the ED on IFRS for SMEs was from Europe, the process of adopting IFRS in Europe alone appears to be burdensome. According to ACCA (2004:1) individual member states of the European Union will move at different speeds to take their national standards for unlisted companies towards IFRS, resulting in a too slow

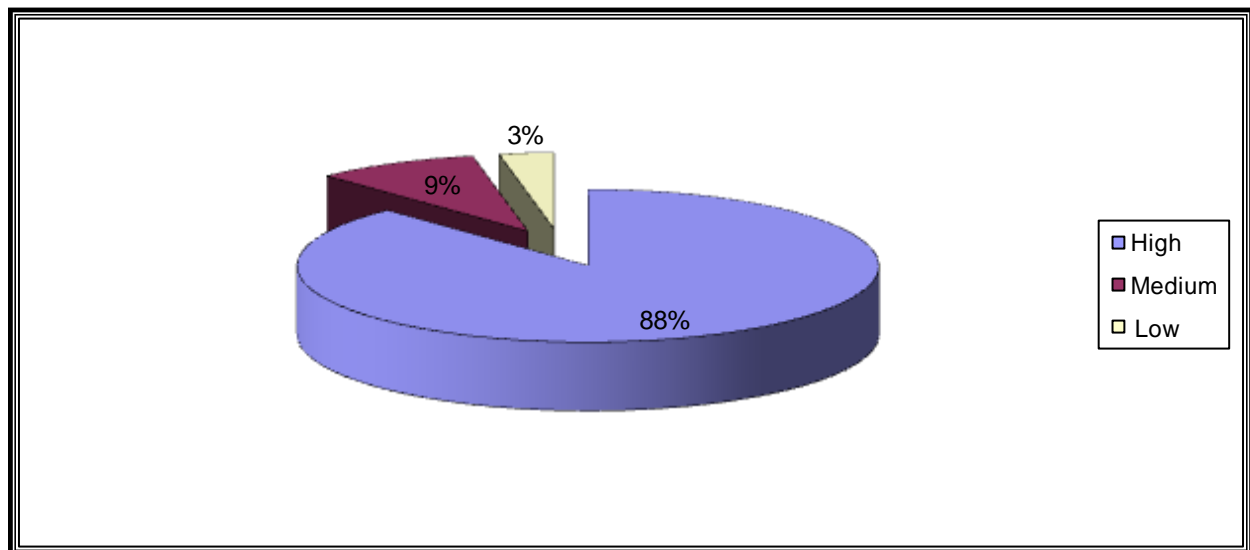
convergence process for some member countries. A possible explanation for the low level of response by the Americas might be attributable to the fact that listed companies in the US are required to compile financial statements in accordance with US GAAP and not IFRS. In addition, SMEs in the US are not legally required to file statutory financial statements in accordance with GAAP or any other relevant reporting standard (Epstein & Jermakowicz, 2007:1). The continent with the lowest number of responses was Africa with 8% of the total responses received. Compared to the continent with the highest number of responses, Europe (58%), where the convergence process to IFRS was reported to be too slow, it is suggested that the process in Africa will be even more burdensome due to unique challenges such as lower levels of development.

#### *2.4. Different levels of development*

The concept of applying global reporting standards to SMEs in developing countries is believed to be more difficult than elsewhere (United Nations, 2008:2). Oberholster (1999:232) suggested that the unique challenges and the heterogeneous nature of developing countries are not necessarily accommodated when International Accounting Standards are adopted by these countries. Simpson (2008:1) also suggested that the IASB did not take into account the uniqueness and challenges of SMEs in developing countries and advocated that the term SME in the ED on IFRS for SMEs is aligned to the US definition of an SME and therefore not necessarily relevant to developing countries. Sacho and Oberholster (2008:128-130) concluded that the implementation of IFRS is not necessarily a “one-size-fits-all” solution for the accounting needs of developing countries. They argued that developing countries do not have historically developed accounting standards and are often required by global market players to apply IFRS, which, according to them, might result in distorted and incongruous results. Although there is no uniform definition available to distinguish developing countries from developed countries, the United Nations developed the Human Development Index (HDI) to measure the level of human development for a specific country. Countries with low to medium HDIs are classified by the United Nations as developing countries. If the responses to the ED on IFRS for SMEs is analysed according to the HDI of each country the number of

respondents/commentators from developing countries is only 12%.

**Figure 2 – HDI classification of respondent countries**



According to Correa-Cortes (2008:1), SMEs from developing countries find it more difficult to cope with typical SME challenges such as limited financial and human resources. Zeghal and Mhedhbi (2006:376) suggested that the decision to adopt IFRS by developing countries, in particular, is influenced by: (i) economic growth; (ii) educational levels; (iii) the degree of external economic openness; (iv) cultural considerations; as well as (v) the existence of capital markets. It is therefore possible that the IASB also did not incorporate the distinctive and unique SME attributes of developing countries.

### **3. Development of hypothesis**

As was mentioned earlier, South Africa<sup>11</sup> was the first country in the world to formally adopt the ED on IFRS for SMEs, which was developed to address the reporting needs of SMEs worldwide.

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<sup>11</sup> South Africa is classified as a developing country due to a medium HDI classification.

A limited number of responses in connection with the ED on IFRS for SMEs were however from developing countries and the African continent. Moreover, the responses were not necessarily from institutions and other bodies with an exclusive SME focus and no statistical evidence exist that the views of SME accountants were considered in developing the IFRS for SMEs. Based hereupon the following hypothesis can be formulated:

*H1:* The IFRS for SMEs will not adequately address the reporting needs of South African SMEs.

As a result we intend to evaluate the contents of the IFRS of SMEs against the SME reporting environment in South Africa. This comparison might be an indication of the extent to which the IFRS of SMEs is applicable and acceptable to SMEs within the South African context.

#### **4. Data and research methodology**

The research encompassed both a literature and empirical study. The literature review considered the unique nature of SMEs, the development of the IFRS for SMEs as well as the various SME role-players. Our literature review revealed that SME environments in different parts of the world are diverse; and that SMEs in different parts of the world do not always engage in similar types of activities, warranting differences in accounting practices by SMEs worldwide.

Our empirical study was conducted to evaluate the contents of the IFRS for SMEs against the actual disclosure practices of SME accountants in South Africa. Our decision to include accounting practitioners was based on the findings by Sian and Roberts (2009:289) that SME owners rely on external accountants to prepare financial statements as well as the conclusion by Schiebel (2008:1) that the IASB considered opinions of mainly auditors and accountants in developing the IFRS for SMEs. We therefore suggest that, in contrast to large and listed companies with effective in-house accounting functions, SME accountants, as preparers of the financial statements, should be considered when evaluating accounting transactions encountered

by SMEs. The views and perceptions of accounting practitioners were also considered important by Van Wyk and Rossouw (2009:102) who argued that accounting practitioners, as preparers of SME financial statements, are involved in the day-to-day transactions of smaller entities and therefore a reliable source for their study. They also argued that users of these financial statements should not be involved due to a lack of understanding of the technical nature of the accounting principles contained in the accounting regulation. The omission of other users of SME financial statements for purposes of our empirical study was further supported by Day (1986:295) who suggested that users of financial statements do not understand the accounting processes as well as the proposition by Schuetze (2001:2) that users of financial statements and reports have almost no grip on the rules governing financial reporting.

Accordingly, in November 2008 responses were obtained from trainee accountants at a preparation course for the South African Institute of Professional Accountants (SAIPA) qualifying exam<sup>12</sup>. In addition to a university qualification these participants gained three year practical experience at a SAIPA accredited training office. Approximately one year later, in November 2009, SME accountants participated in our study at a SAIPA national accounting update seminar. Respondents from large and public entities were omitted and not considered for this study. The participants responded to the contents of the IFRS for SMEs using a five-point Likert scale (Refer to annexure F). With regard to the analysis stage, the use of Likert scales requires the use of a ranking procedure with 1 minimum and 5 maximum score. According to annexure B and C the survey consisted of 31 trainee accountants and 126 practitioners. With regard to the unequal split between the number of trainee accountants and practitioners included in the survey it was not our intention to compare and interpret differences in results between the two groups in detail. In addition to the fact that the survey of the trainee accountants was conducted as a pre-test for our survey of accounting practitioners and even though this group might not have the same level of experience, we included their responses as a control group in our study. Our decision to include this group was further supported by their practical exposure to

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<sup>12</sup> Trainee accountants are entitled to write the SAIPA qualifying exam after a three year training contract at a SAIPA accredited training office.

the SME accounting environment as well as the fact that they, subject to passing the qualifying exam, are entitled to practice as SME accountants. Accordingly we calculated the *mean* ranking by practitioners and trainee accountants pertaining to the contents of the IFRS for SMEs. In addition, for purposes of an analysis of commonality amongst the alternative sample groups, and to assess whether the means of the two groups are statistically different from each other, we performed an independent group *t*-test at a 95% confidence level.

Based on the above *mean* ranking by practitioners and trainee accountants we arranged the contents of the IFRS for SMEs in a sequential hierarchy of importance. As a result we considered the appropriateness of the contents of the IFRS for SMEs pertaining to the South African SME environment.

## 5. Results

When the responses of the two groups were considered we noted that the *mean* answers in annexure D were very similar ranging from the lowest difference of 0.047 for Provisions and Contingencies to an uppermost difference of 1.186 for Leases. Only two components, leases and share-based payments, revealed a *mean* difference in excess of one ranking. The standard deviation between the *mean* scores of the two groups of respondents amounted to 0.554.

Furthermore, *t*-tests performed per IFRS for SME component in annexure E revealed no significant difference, except for lease transactions, between the *mean* answer of the two groups.

As a result, we combined the results of the two groups and calculated a combined *mean* in annexure D, expressed as:

$$\frac{\sum_{i=1}^n (\text{Practitioners}_i + \text{Trainees}_i)}{(n \text{ practitioners} + n \text{ trainees})} \quad [1]$$

where *n* represents the number of answers per group and *i* represents the component of IFRS for

SMEs. Based hereupon we ranked the contents of the IFRS for SME in sequence of importance. Firstly, from our analysis in table 1, we noted that the general structure or format in which the financial statements should be compiled is considered necessary and essential as the mean ranking was between very and of utmost importance.

**Table 1 – Components of IFRS for SMEs relating to general structure of financial statements**

<u>Component of Statement of GAAP for SMEs</u>	<u>Abbreviation</u>	<u>Combined Mean</u>	<u>Combined Standard deviation</u>
Balance Sheet	Balance Sheet	4.860	0.587
Income Statement	Income Statement	4.841	0.415
Financial Statement Presentation	FS Presentation	4.771	0.446
Notes to the Financial statements	Notes to the FS	4.389	0.984
Statement of Changes in Equity	Changes in Equity	4.382	1.130
Cash Flow Statement	Cash Flow Statement	4.274	0.958

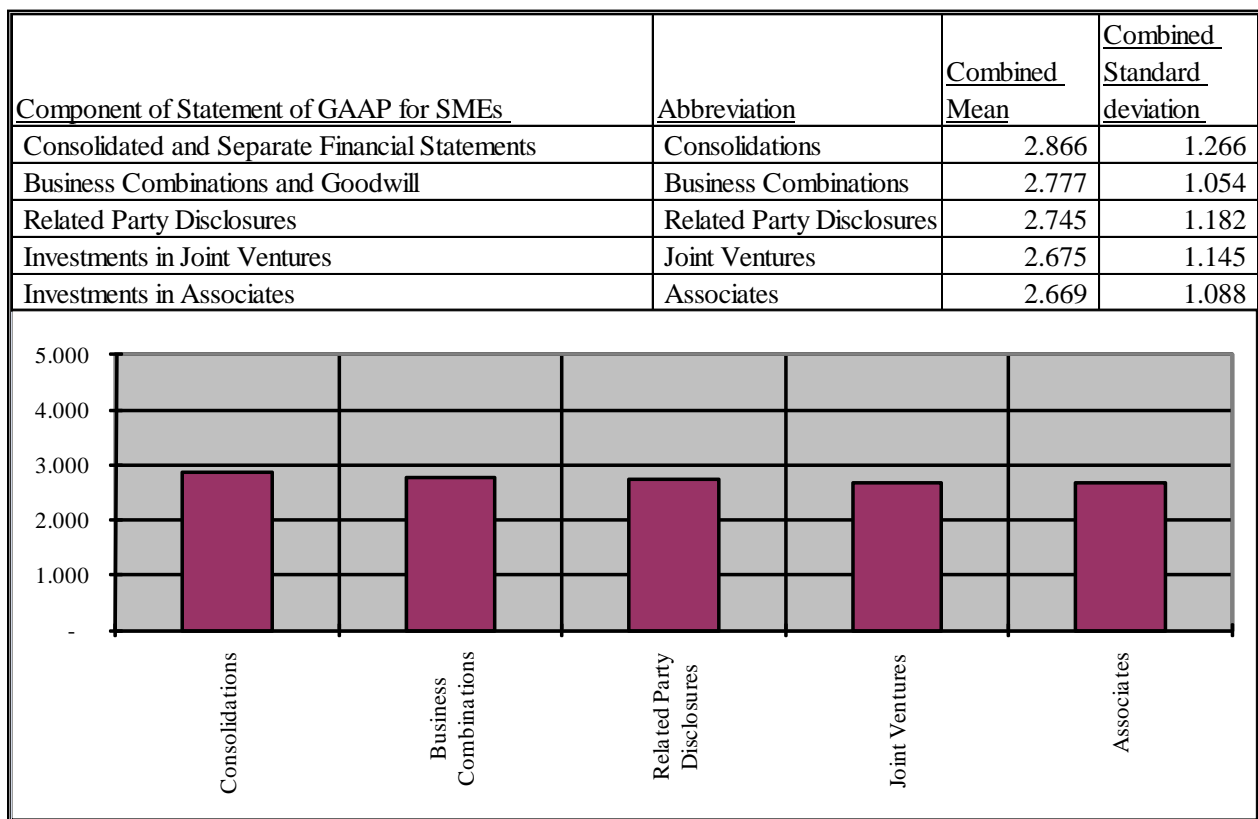
Component	Combined Mean
Balance Sheet	4.860
Income Statement	4.841
FS Presentation	4.771
Notes to the FS	4.389
Changes in Equity	4.382
Cash Flow Statement	4.274

We noted that the statement of changes in equity (4.382) and the statement of cash flows (4.274) as well as the notes to the financial statements (4.389) were not rated as important as the balance sheet/statement of financial position (4.860) and income statement/statement of comprehensive income (4.841). The statement of cash flows, statement of changes in equity and the notes to the financial statements were ranked slightly less important than the balance sheet and income statement. These sections also revealed significantly higher standard deviations suggesting

variances in opinions concerning the importance of components of SME financial statements other than the balance sheet and the income statement.

Secondly, from the perspective of business combinations and related inter-group transactions the results in table 2 revealed a *mean* ranking of between *limited* and *average importance*. It is therefore evident that SMEs do not often engage in these types of transactions.

**Table 2 – Components of IFRS for SMEs relating to business combinations and related transactions**



Our results suggest that Consolidated and Separate Financial Statements (2.866); Business Combinations and Goodwill (2.777); Related Party Disclosures (2.745); Investments in Joint Ventures (2.675); and Investments in Associates (2.669) are not typical SME transactions as the ranking for all the components was below the centre option (3.000). Our results suggest that the South African SMEs included in our sample do not prepare consolidated financial statements, albeit on a national or international level. This provided support for the statement by Van Mourik

(2007:193) that SMEs do not have a global focus. Moreover, our results revealed that South African SMEs do not invest directly in other businesses and that the activities of SMEs are therefore not diverse, but limited to a single product line or business purpose.

In the third instance we analysed the IFRS for SMEs pertaining to specific types of transactions in table 3. Our results revealed that guidance in connections with specific transactions were ranked from *limited to very important*.

**Table 3 – Components of IFRS for SMEs relating to specific types of transactions**

<u>Component of Statement of GAAP for SMEs</u>	<u>Abbreviation</u>	<u>Combined Mean</u>	<u>Combined Standard deviation</u>
Financial Assets and Liabilities	Fin A&L	4.287	0.863
Property, Plant and Equipment	PPE	4.121	1.076
Income Taxes	Inc Tax	4.102	1.272
Revenue	Revenue	4.064	1.090
Equity	Equity	4.025	0.920
Inventories	Inventories	3.866	1.098
Leases	Leases	3.790	1.160
Employee Benefits	Empl Cost	3.618	1.174
Investment Property	Inv Prop	3.592	1.138
Accountings Policies, Estimates and Errors	Acc Pol	3.573	1.081
Provisions and Contingencies	Prov	3.414	1.086
Agriculture	Agric	3.102	1.481
Borrowing Costs	Borr Cost	3.096	1.102
Intangible Assets other than Goodwill	Intan Ass	3.076	1.135
Impairment of Non-financial Assets	Impairm	2.917	1.176
Events after the End of the Reporting Period	Events after BS	2.707	1.156
Government Grants	Gov Grants	2.701	1.124
Hyperinflationary Economics	Hyperinfl	2.350	1.339
Foreign Currency Translation	Forex	2.299	1.258
Share-based Payments	SB Pmts	2.268	1.168
Extracting Activities	Extracting Act	2.210	1.115
Service Concessions	Service Cons	2.210	1.132

Component	Mean Value
Fin A&L	4.287
PPE	4.121
Inc Tax	4.102
Revenue	4.064
Equity	4.025
Inventories	3.866
Leases	3.790
Empl Cost	3.618
Inv Prop	3.592
Acc Pol	3.573
Prov	3.414
Agric	3.102
Borr Cost	3.096
Intan Ass	3.076
Impairm	2.917
Events after BS	2.707
Gov Grants	2.701
Hyperinfl	2.350
Forex	2.299
SB Pmts	2.268
Extracting Act	2.210
Service Cons	2.210

We noted that Financial Assets/Liabilities (4.287) and Property, Plant and Equipment (4.121) were considered the most important. These two items were considered even more important than

Income Taxes (4.102). Accounting Policies, Estimates and Errors (3.573) were ranked tenth while Extracting Activities (2.210) and Service Concessions (2.210) were not considered important.

Due to different levels of perceived importance of the components as presented in table 3 we attempted to classify these components into three main categories. These categories were determined based on the mean answer of each component rounded off to the nearest ranking, classified as highly important, moderately important and of less importance in table 4.

**Table 4 – Classification of components of IFRS for SMEs relating to specific types of transactions in order of importance**

<b>Highly important (4 ranking):</b>	
Financial Assets and Liabilities	Income Taxes
Property, Plant and Equipment	Revenue
Equity	Inventories
Leases	Employee Benefits
Accountings Policies, Estimates & Errors	Investment Property
<b>Moderately important (3 ranking):</b>	
Provisions and Contingencies	Agriculture
Borrowing Costs	Intangible Assets
Impairment of Non-financial Assets	Events after the End of the Reporting Period
Government Grants	
<b>Less important (2 ranking):</b>	
Hyperinflationary Economics	Foreign Currency Translation
Share-based Payments	Extracting Activities
Service Concessions	

## 6. Discussion and conclusion

The results in table 1 confirmed the relative importance of the components of the financial statements, as a normal set of financial statements comprise a balance sheet or statement of financial position; income statement or statement of comprehensive income; statement of changes in equity; statement of cash flows; as well as notes to the financial statements. However,

the fact that all the components of the financial statements were not ranked equally might be indicative of the fact that certain components are compiled for purposes of formality only and not necessarily for informational and decision-making purposes. In support of the statement by Sian and Roberts (2009:299) our results also suggest that the balance sheet and income statement are more often used than the statement of cash flows, statement of changes in equity and the notes to the financial statements.

Our analysis in table 2 suggested that South African SMEs do not engage in investments in subsidiaries, associates or joint ventures. The fact that SMEs in South Africa do not engage in these types of transactions imply that SMEs do not invest directly in other businesses and product lines; and the fact that South African SMEs do not engage in a diverse range of activities might be indicative of exaggeratedly dependence on a single range of products or activities and vulnerability to specific market risks. Our analysis in table 2 also provided support for the OECD in connection with SMEs' involvement in international business. South African SMEs' involvement in investments in subsidiaries, associates and joint ventures, albeit national or international, is limited. The fact that SMEs' shares are not publicly traded implies that international investors are also not investing in South African SMEs. Furthermore, the fact that foreign exchange translation was ranked low in terms of importance confirmed to us that SMEs are mainly involved in economies that are geographically and culturally close.

We observed from table 3 and table 4 that seven of a total 33 components were rated of moderate importance. Included in this group were provisions as well as impairment of non-financial assets. In the wake of the global financial crisis we believe that these two components should be more important. The results might suggest that accountants do not realise their obligation to account for impairment in values and to account for provisions or that SMEs follow alternative procedures to deal with financial uncertainty.

The components pertaining to specialised activities were ranked of moderate to limited importance. Firstly, agriculture was ranked moderately important. The remaining two specialised activities, extracting activities and service concessions, were ranked of limited importance, perhaps indicating that SMEs in South Africa are involved in different or alternative specialised activities. The fact that a limited importance ranking was obtained for hyperinflation economies

might be attributable to the fact that South Africa did not experience hyperinflationary conditions in recent times.

In conclusion, due to the fact that most of the components (70%) were either of high or moderate importance, while only 30% was considered less important it appears as if the IFRS for SMEs is likely to adequately address the reporting requirements of SMEs in South Africa, therefore our hypothesis is rejected. We suggest however that, based on the results in table 2, the adoption of the IFRS for SMEs will be complicated by the dissonance between a global/international focus and limited involvement in international business by South African SMEs.

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**Annexure A – Responses to ED on IFRS for SMEs - per country in descending order**

<u>Country</u>	<u>Number of responses</u>	<u>Country</u>	<u>Number of responses</u>
United Kingdom	20	Denmark	1
International	16	Greece	1
Germany	11	Hong Kong	1
Australia	8	India	1
Belgium	4	Ireland	1
New Zealand	4	Israel	1
Italy	3	Korea	1
Japan	3	Malawi	1
South Africa	3	Malta	1
Sweden	3	Mexico	1
Argentina	2	Norway	1
Canada	2	Pakistan	1
Columbia	2	Portugal	1
Finland	2	Russia	1
France	2	Singapore	1
Malaysia	2	Spain	1
Mozambique	2	Sri Lanka	1
Netherlands	2	Swaziland	1
USA	2	Switzerland	1
Brazil	1	Vatican	1
Bulgaria	1	Zambia	1

**Annexure A (continued) – Other respondents to the ED on IFRS for SMEs**

- KPMG
- PricewaterhouseCoopers
- Federation of Accountants
- United Nations Conference on Trade and Development
- EUROCHAMBRES -Association of European Chambers of Commerce and Industry
- European Accounting Association
- European Commission
- European Federation of Accountants and Auditors for SMEs
- European Financial Reporting Advisory Group
- European Private Equity and Venture Capital Association
- Financial Executives
- III WG of the European Committee of Central Balance Sheet Data Offices
- Moore Rowland Europe
- Raggy, David Member, IASB Advisory Panel on Small and Medium-sized Entities
- European Association of Co-operative Banks (EACB)
- Federation des Experts Comtables Europeens

## Annexure B – Analysis of responses to contents of IFRS for SMEs (practitioners)

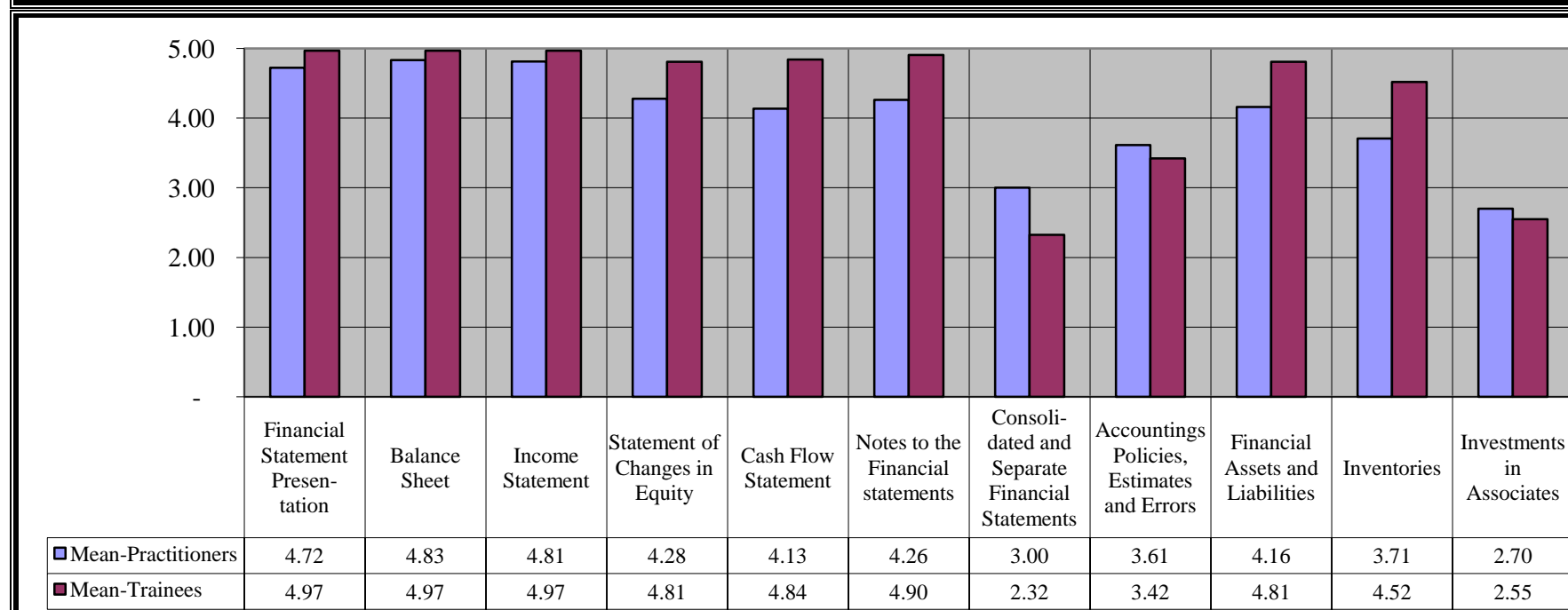
	<i>mean</i>	<i>mode</i>	<i>median</i>	<i>variance</i>	<i>standard deviation</i>	<i>coefficient of variation</i>	<i>kurtosis</i>	<i>skewness</i>	<i>min</i>	<i>max</i>	<i>count</i>
<u>Component of IFRS for SMEs</u>											
Financial Statement Presentation	4.72	5	5	0.410	0.640	13.56%	9.833	-2.833	1	5	126
Balance Sheet	4.83	5	5	0.204	0.452	9.34%	7.322	-2.794	3	5	126
Income Statement	4.81	5	5	0.235	0.485	10.09%	5.976	-2.584	3	5	126
Statement of Changes in Equity	4.28	5	5	1.114	1.056	24.68%	1.548	-1.491	1	5	126
Cash Flow Statement	4.13	5	5	1.446	1.202	29.08%	0.862	-1.358	1	5	126
Notes to the Financial statements	4.26	5	5	1.043	1.021	23.96%	0.930	-1.326	1	5	126
Consolidated and Separate Financial Statements	3.00	2	3	1.792	1.339	44.62%	-1.171	0.041	1	5	126
Accountings Policies, Estimates and Errors	3.61	4	4	1.328	1.152	31.91%	-0.451	-0.563	1	5	126
Financial Assets and Liabilities	4.16	5	4	0.807	0.898	21.60%	0.653	-0.993	1	5	126
Inventories	3.71	4	4	1.297	1.139	30.73%	-0.168	-0.721	1	5	126
Investments in Associates	2.70	3	3	1.396	1.182	43.79%	-0.789	0.135	1	5	126
Investments in Joint Ventures	2.77	3	3	1.539	1.240	44.78%	-0.883	0.168	1	5	126
Investment Property	3.46	4	4	1.402	1.184	34.22%	-0.644	-0.403	1	5	126
Property, Plant and Equipment	3.98	5	4	1.287	1.135	28.54%	0.029	-0.921	1	5	126
Intangible Assets other than Goodwill	3.13	3	3	1.494	1.222	38.99%	-0.858	-0.102	1	5	126
Business Combinations and Goodwill	2.84	3	3	1.255	1.120	39.42%	-0.534	0.146	1	5	126
Leases	3.56	4	4	1.353	1.163	32.71%	-0.608	-0.462	1	5	126
Provisions and Contingencies	3.40	3	3	1.331	1.154	33.88%	-0.467	-0.399	1	5	126
Equity	3.92	4	4	0.938	0.968	24.70%	0.295	-0.699	1	5	126
Revenue	3.94	5	4	1.333	1.155	29.27%	0.545	-1.095	1	5	126
Government Grants	2.78	3	3	1.438	1.199	43.17%	-0.734	0.128	1	5	126
Borrowing Costs	3.04	3	3	1.334	1.155	38.00%	-0.760	-0.047	1	5	126
Share-based Payments	2.47	2	2	1.419	1.191	48.26%	-0.465	0.524	1	5	126
Impairment of Non-financial Assets	3.02	3	3	1.552	1.246	41.30%	-0.853	0.045	1	5	126
Employee Benefits	3.54	5	4	1.594	1.263	35.67%	-0.901	-0.406	1	5	126
Income Taxes	3.92	5	5	1.818	1.348	34.39%	-0.511	-0.908	1	5	126
Hyperinflationary Economics	2.51	1	2	2.060	1.435	57.23%	-1.050	0.487	1	5	126
Foreign Currency Translation	2.44	1	2	1.769	1.330	54.41%	-0.861	0.526	1	5	126
Events after the End of the Reporting Period	2.73	3	3	1.559	1.248	45.73%	-0.996	0.151	1	5	126
Related Party Disclosures	2.67	3	3	1.581	1.257	47.02%	-1.022	0.148	1	5	126
Specialised Activities: Agriculture	3.05	5	3	2.350	1.533	50.30%	-1.472	0.054	1	5	126
Specialised Activities: Extracting Activities	2.24	1	2	1.335	1.155	51.62%	-0.258	0.659	1	5	126
Specialised Activities: Service Concessions	2.23	1	2	1.427	1.194	53.56%	-0.269	0.746	1	5	126

### Annexure C – Analysis of responses to contents of IFRS for SMEs (trainee accountants)

	<i>mean</i>	<i>mode</i>	<i>median</i>	<i>variance</i>	<i>standard deviation</i>	<i>coefficient of variation</i>	<i>kurtosis</i>	<i>skewness</i>	<i>min</i>	<i>max</i>	<i>count</i>
<b>Component of IFRS for SMEs</b>											
Financial Statement Presentation	4.97	5	5	0.032	0.180	3.62%	31.000	-5.568	4	5	31
Balance Sheet	4.97	5	5	0.032	0.180	3.62%	31.000	-5.568	4	5	31
Income Statement	4.97	5	5	0.032	0.180	3.62%	31.000	-5.568	4	5	31
Statement of Changes in Equity	4.81	5	5	0.161	0.402	8.36%	0.702	-1.631	4	5	31
Cash Flow Statement	4.84	5	5	0.206	0.454	9.39%	9.031	-2.991	3	5	31
Notes to the Financial statements	4.90	5	5	0.090	0.301	6.13%	6.654	-2.868	4	5	31
Consolidated and Separate Financial Statements	2.32	3	2	0.492	0.702	30.21%	-0.751	-0.550	1	3	31
Accountings Policies, Estimates and Errors	3.42	3	3	0.518	0.720	21.05%	0.063	0.301	2	5	31
Financial Assets and Liabilities	4.81	5	5	0.161	0.402	8.36%	0.702	-1.631	4	5	31
Inventories	4.52	5	5	0.325	0.570	12.62%	-0.569	-0.644	3	5	31
Investments in Associates	2.55	3	3	0.323	0.568	22.29%	-0.358	-0.784	1	3	31
Investments in Joint Ventures	2.29	2	2	0.213	0.461	20.15%	-1.134	0.972	2	3	31
Investment Property	4.13	4	4	0.516	0.718	17.40%	-0.954	-0.198	3	5	31
Property, Plant and Equipment	4.71	5	5	0.213	0.461	9.80%	-1.134	-0.972	4	5	31
Intangible Assets other than Goodwill	2.84	3	3	0.406	0.638	22.46%	-0.431	0.142	2	4	31
Business Combinations and Goodwill	2.52	3	3	0.458	0.677	26.90%	0.002	-0.407	1	4	31
Leases	4.74	5	5	0.198	0.445	9.38%	-0.697	-1.163	4	5	31
Provisions and Contingencies	3.45	3	3	0.589	0.768	22.24%	-0.077	0.409	2	5	31
Equity	4.45	4	4	0.256	0.506	11.36%	-2.098	0.204	4	5	31
Revenue	4.55	5	5	0.323	0.568	12.49%	-0.358	-0.784	3	5	31
Government Grants	2.39	2	2	0.445	0.667	27.95%	0.009	0.083	1	4	31
Borrowing Costs	3.32	3	3	0.692	0.832	25.05%	-0.473	0.053	2	5	31
Share-based Payments	1.45	1	1	0.323	0.568	39.13%	-0.358	0.784	1	3	31
Impairment of Non-financial Assets	2.52	3	3	0.525	0.724	28.79%	-0.078	-0.060	1	4	31
Employee Benefits	3.94	4	4	0.396	0.629	15.98%	-0.261	0.044	3	5	31
Income Taxes	4.84	5	5	0.140	0.374	7.73%	1.868	-1.937	4	5	31
Hyperinflationary Economics	1.71	2	2	0.213	0.461	26.99%	-1.134	-0.972	1	2	31
Foreign Currency Translation	1.71	2	2	0.413	0.643	37.58%	-0.585	0.342	1	3	31
Events after the End of the Reporting Period	2.61	3	3	0.445	0.667	25.53%	0.009	-0.083	1	4	31
Related Party Disclosures	3.03	3	3	0.566	0.752	24.80%	-1.164	-0.054	2	4	31
Specialised Activities: Agriculture	3.32	2	3	1.559	1.249	37.58%	-1.368	-0.006	1	5	31
Specialised Activities: Extracting Activities	2.10	2	2	0.890	0.944	45.00%	1.799	1.070	1	5	31
Specialised Activities: Service Concessions	2.13	2	2	0.716	0.846	39.75%	-0.156	0.448	1	4	31

### Annexure D – Rating of IFRS for SMEs contents by practitioners and trainees

Component of Statement of GAAP for SMEs	Financial Statement Presentation	Balance Sheet	Income Statement	Statement of Changes in Equity	Cash Flow Statement	Notes to the Financial statements	Consolidated and Separate Financial Statements	Accountings Policies, Estimates and Errors	Financial Assets and Liabilities	Inventories	Investments in Associates
Mean-Practitioners	4.72	4.83	4.81	4.28	4.13	4.26	3.00	3.61	4.16	3.71	2.70
Mean-Trainees	4.97	4.97	4.97	4.81	4.84	4.90	2.32	3.42	4.81	4.52	2.55
Mean difference	-0.25	-0.13	-0.16	-0.53	-0.70	-0.64	0.68	0.19	-0.65	-0.81	0.15
Combined Mean	4.77	4.86	4.84	4.38	4.27	4.39	2.87	3.57	4.29	3.87	2.67



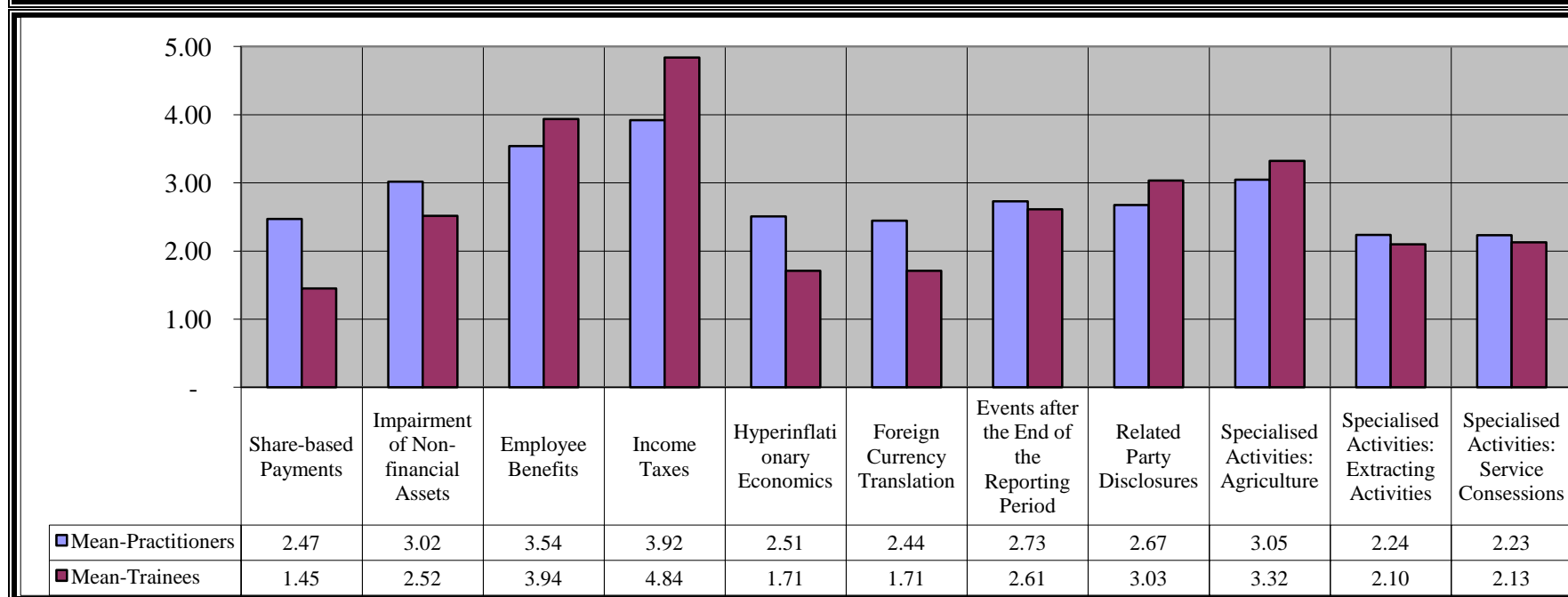
**Annexure D – Rating of IFRS for SMEs contents by practitioners and trainees (continued)**

Component of Statement of GAAP for SMEs	Investments in Joint Ventures	Investment Property	Property, Plant and Equipment	Intangible Assets other than Goodwill	Business Combinations and Goodwill	Leases	Provisions and Contingencies	Equity	Revenue	Government Grants	Borrowing Costs
Mean-Practitioners	2.77	3.46	3.98	3.13	2.84	3.56	3.40	3.92	3.94	2.78	3.04
Mean-Trainees	2.29	4.13	4.71	2.84	2.52	4.74	3.45	4.45	4.55	2.39	3.32
Mean difference	0.48	-0.67	-0.73	0.30	0.33	-1.19	-0.05	-0.53	-0.60	0.39	-0.28
Combined Mean	2.68	3.59	4.12	3.08	2.78	3.79	3.41	4.03	4.06	2.70	3.10



**Annexure D – Rating of IFRS for SMEs contents by practitioners and trainees (continued)**

Component of Statement of GAAP for SMEs	Share-based Payments	Impairment of Non-financial Assets	Employee Benefits	Income Taxes	Hyperinflationary Economics	Foreign Currency Translation	Events after the End of the Reporting Period	Related Party Disclosures	Specialised Activities: Agriculture	Specialised Activities: Extracting Activities	Specialised Activities: Service Concessions
Mean-Practitioners	2.47	3.02	3.54	3.92	2.51	2.44	2.73	2.67	3.05	2.24	2.23
Mean-Trainees	1.45	2.52	3.94	4.84	1.71	1.71	2.61	3.03	3.32	2.10	2.13
Mean difference	1.02	0.50	-0.40	-0.92	0.80	0.73	0.12	-0.36	-0.27	0.14	0.10
Combined Mean	2.27	2.92	3.62	4.10	2.35	2.30	2.71	2.75	3.10	2.21	2.21



**Annexure E – Variances between practitioners and trainees in connection with contents of IFRS for SMEs**

Component of IFRS for SMEs	t-value	p-value	F-ratio variances	p- variances
Financial Statement Presentation	-0.510	0.614	0.000	1.000
Balance Sheet	-0.322	0.749	0.000	1.000
Income Statement	-0.379	0.707	0.000	1.000
Statement of Changes in Equity	-0.682	0.501	1.867	0.506
Cash Flow Statement	-1.155	0.258	6.462	0.285
Notes to the Financial statements	-0.873	0.390	3.984	0.440
Consolidated and Separate Financial Statements	1.215	0.236	1.058	0.928
Accountings Policies, Estimates and Errors	0.012	0.990	1.285	0.701
Financial Assets and Liabilities	0.528	0.602	2.047	0.437
Inventories	-0.580	0.570	0.000	1.000
Investments in Associates	-0.178	0.860	1.362	0.611
Investments in Joint Ventures	0.918	0.366	2.505	0.183
Investment Property	-0.354	0.726	1.082	0.934
Property, Plant and Equipment	-0.953	0.349	1.590	0.511
Intangible Assets other than Goodwill	-0.461	0.649	1.245	0.666
Business Combinations and Goodwill	1.135	0.279	2.348	0.945
Leases	-2.219	0.034	2.613	0.080
Provisions and Contingencies	-1.927	0.080	2.593	0.258
Equity	0.311	0.758	1.276	0.636
Revenue	-0.611	0.546	1.276	0.694
Government Grants	-0.665	0.512	1.128	0.857
Borrowing Costs	1.820	0.092	0.000	1.000
Share-based Payments	0.411	0.684	1.255	0.653
Impairment of Non-financial Assets	-1.319	0.199	1.234	0.722
Employee Benefits	-1.162	0.257	1.515	0.635
Income Taxes	-0.374	0.711	1.486	0.473
Hyperinflationary Economics	-1.239	0.225	1.969	0.326
Foreign Currency Translation	-1.115	0.275	1.908	0.283
Events after the End of the Reporting Period	-1.369	0.191	0.000	1.000
Related Party Disclosures	0.177	0.861	4.527	0.039
Specialised Activities: Agriculture	-0.332	0.745	1.280	0.694
Specialised Activities: Extracting Activities	-0.971	0.342	1.987	0.260
Specialised Activities: Service Concessions	-0.869	0.395	1.449	0.530

## Annexure F – Questionnaire regarding the importance of the contents of IFRS for SMEs

Initials and surname: \_\_\_\_\_

Small/medium or large firm: \_\_\_\_\_(mandatory)

Please indicate the level of importance of the following sections pertaining to your own practice/working environment:

Of utmost importance = 5  
 Very important = 4  
 Important = 3  
 Limited importance = 2  
 Not important = 1

<u>Component of IFRS for SMEs</u>	
Financial Statement Presentation	
Balance Sheet/Statement of Financial Position	
Income Statement/Statement of Comprehensive Income	
Statement of Changes in Equity	
Cash Flow Statement	
Notes to the Financial statements	
Consolidated and Separate Financial Statements	
Accountings Policies, Estimates and Errors	
Financial Assets and Liabilities	
Inventories	
Investments in Associates	
Investments in Joint Ventures	
Investment Property	

Property, Plant and Equipment	
Intangible Assets other than Goodwill	
Business Combinations and Goodwill	
Leases	
Provisions and Contingencies	
Liabilities and Equity	
Revenue	
Government Grants	
Borrowing Costs	
Share-based Payments	
Impairment of Assets	
Employee Benefits	
Income Taxes	
Hyperinflationary Economics	
Foreign Currency Translation	
Events after the End of the Reporting Period	
Related Party Disclosures	
Specialised Activities: Agriculture	
Specialised Activities: Extracting Activities	
Specialised Activities: Service Concessions	

## **Annexure G – Guide for authors (South African Journal of Economic and Management Sciences)**

### **Requirements for manuscript submission**

All submissions are to be written in English.

We request that you submit two documents: a title page and an anonymous manuscript, i.e., the entire manuscript without author or contact information. The separate title page should include the title, the abstract (no more than 135 words), Journal of Economic Literature ([www.aeaweb.org/journal/jel\\_class\\_system.html](http://www.aeaweb.org/journal/jel_class_system.html)) classification number, keywords, the author(s), their institutional affiliations, and the contact details of the corresponding author. You are welcome to submit the documents in word or pdf format via email to [sajems@up.ac.za](mailto:sajems@up.ac.za).

Submission of a manuscript confirms that the research was conducted by the listed author(s), and that it is not under consideration at any other journal. SAJEMS condones neither plagiarism (<http://en.wikipedia.org/wiki/Plagiarism>) nor the infringement of copyright ([http://en.wikipedia.org/wiki/Copyright\\_infringement](http://en.wikipedia.org/wiki/Copyright_infringement)). Violation of either of these principles will result in immediate rejection and follow-up with the author's or authors' institution(s). Submission of a manuscript to SAJEMS implies author consent to the preceding principles.

### **Format of Manuscript**

Authors of accepted papers are asked to place their article into the journal's format, after which it is text edited by SAJEMS' language consultants. Edited papers are returned to the author(s) for approval. We ask authors to submit the accepted text edited version within three days, following which, it is sent to the publishers.

Section headings should be bold integer values, e.g., **1**, **2** and **3**. Subsection headings should also be bold and numbered sequentially, e.g., **2.1** and **2.2**. Sub-subsection headings should be italicized, e.g., *2.2.1* and *2.2.2*. Further sub-headings should follow as: 2.2.1.1 and 2.2.1.2. We ask that articles not be broken further than that. Appendix enumeration is to follow a similar pattern: **A** and **B**, **A.1** and **A.2**, *A.2.1* and *A.2.2*, and, finally, A.2.1.1 and A.2.1.2.

Any thanks, acknowledgements or other considerations should be placed in a final section of the paper; the heading of the section should be "Acknowledgements".

Endnotes are to be used, and not footnotes. These should be numbered sequentially and placed immediately following the text of the manuscript.

Tables should be self-explanatory in all instances, i.e., a reader should be able to open to the table and know what is in it, without reading the article. The title and reference number of the table should be placed at the top of the table and the tables should be numbered consecutively throughout the manuscript, and not within sections. Notes immediately following the table should explain any symbols or other useful information to the reader. The source of the table and any software used to calculate the numbers in the table should be listed. Avoid using variable names; instead use accurate, but short descriptions that are easily understood.

Figures should be self-explanatory in all instances. The caption and number of the figure should be placed at the bottom of the figure. Figures should be numbered consecutively throughout the manuscript. Any notes describing the figure should be included immediately below the figure, and that must include the source of the figure and any software used to create the figure, especially if specific calculations were required.

Equations should be numbered consecutively, and those numbers should appear to the right of the equation. Theorems, lemmas, corollaries and proofs should also be numbered consecutively; however, we prefer that proofs be relegated to the appendix, in order to maintain the flow of the manuscript.

Referencing should follow the Harvard referencing system.

## CHAPTER 6 (Article 5)

### ***Title: A comparative evaluation of South African SME financial statements against the IFRS requirements***<sup>13</sup>

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<sup>13</sup> The reader should take note of the following:

The article has been co-authored with the study promoter and submitted for publication by the following peer reviewed IBSS indexed and Department of Education accredited journal as:

Schutte, D.P. and Buys, P.W. 2010. A comparative evaluation of South African SME financial statements against the IFRS requirements. *Studia Universitatis Babeş Bolyai Oeconomica* (unpublished) (ISSN 1220-0506).

The article was researched and written by the first author as the candidate. The 2<sup>nd</sup> author fulfilled a 'reviewer' function thereto as the study promoter. Estimated weightings of contribution are as follows:

- Schutte, D.P. (85%)
- Buys, P.W. (15%)

## **Abstract**

Research revealed that strong enforcement of accounting standards would improve the quality of financial reporting. As a result, information communicated by management to existing and potential shareholders should also improve.

Proper financial reporting is however not necessarily an SME objective. Traditionally SME owners also fulfil a management function in the business. Moreover, little evidence exist that disclosure practices of SMEs are monitored. Notwithstanding these circumstances the IFRS for SMEs was developed for the SME sector worldwide. The relevance and adequacy of this accounting framework to the SME sector is therefore doubtful.

This study compares current disclosure practices by South African SMEs against the IFRS for SMEs' illustrative financial statements. Based on a sample of financial statements from the SME sector in South Africa our results suggest to what extent the illustrative financial statements is suitable for South African SMEs.

**JEL classification:** M41 – Accounting; M48 – Government Policy and Regulation

**Key words:** Accounting, General Accepted Accounting Practice, International Financial Reporting Standards, Small and Medium Entities.

## 1. Introduction

When considering conventional accounting research the focus is often on the objective quantitative data that is publicly available such as stock exchanges, etc. Practising accountants are however also entrusted with a stewardship role and is also very much involved in the preparation of such data. Yet minimal accounting research seems to be conducted in this specific preparatory area of accounting. Although Ball and Foster (1982:164-169) suggested that the financial statements exemplify the database in empirical accounting research, the focus of researchers in recent times was not so much on the database/financial statements, but rather on the development of International Financial Reporting Standards (IFRS) and, more recently, on the adoption of these standards by large industrialised countries, such as the United States (US), Canada, and members of the European Union. According to Zeghal and Mhedhbi (2006:374) empirical research on the adoption of IFRS is of a general nature only and limited to a description of particular circumstances. Very early on Ball and Foster (1982:164) identified major differences between empirical research in the field of accounting (as a social science) compared to research in the basic scientific disciplines. They advocated that accounting researchers are confronted by the imperfect match between the theoretical background of the accounting discipline and the institutional data presented by accountants. In addition they identified major differences between accounting research and work undertaken by practitioners, suggesting that *good* accounting research might not satisfy either the disciplinary purist or the practicing accountant.

In addition to differences between accounting and non-accounting disciplines, evidence of diversity within the discipline of accounting also exists. A number of researchers, such as Gannon and Ashwal (2004:43) as well as Zanzig and Flesher (2006:1), revealed inconsistencies in national and international accounting practices. As a result many governments, accounting regulators and other governing bodies called for accounting harmonisation. Van der Tas (1988:157) defined the term harmonisation as the coordination, or the tuning of two or more objects. Accounting harmonisation therefore implies coordination between two or more sets of financial statements. According to Van der Tas (1988:158) accounting harmonisation can either be formal as a result of the standard setting process or spontaneous without being influenced by

accounting standards. The degree of formality is further influenced by the degree of legal backing for accounting standards. Although accounting is considered to be self regulated by the professional values, ethical rules and governing bodies prescribing business practices, Willmott, Puxty, Robson, Cooper and Lowe (1992:33) suggested that the state should be more involved in mediating the process of accounting regulation. As a result legislative backing for accounting standards was introduced in the US, United Kingdom (UK), Canada, Australia and elsewhere (Sawani, 2009:1; Bradbury & Van Zijl, 2005:78).

Although legal backing for accounting standards and related reporting frameworks for companies were identified as one of the critical components of the corporate reform process, the situation in South Africa remains uncertain. Apart from disclosure requirements for listed companies little evidence exists that disclosure practices and related adherence to accounting standards of unlisted SMEs are monitored. We therefore suggest that the format of financial statements of the SME sector in South Africa was, to a certain extent, the subject of spontaneous harmonisation due to limited enforcement and monitoring of adherence to accounting standards.

Our research was further complicated by the lack of formalities of SMEs (White Paper, 1995:11) as well as the fact that most information is often considered confidential. SMEs do not disclose all the information utilised in similar research projects pertaining to listed companies. Moreover, in contrast to the financial statements of listed companies, SME financial statements were not readily available. Despite these limitations we attempted to analyse disclosure practices from a sample of SME financial statements and to compare the content thereof to the illustrative financial statements of the recently announced IFRS for SMEs. Our inductive study is structured as follows: section two describes the general theoretical framework and covers the relevant literature review; section three introduces the hypothesis to be tested in the study; while, section four introduces the methodology and our data sample. All results are presented and discussed in section five. The study concludes in section six after which limitations and recommendations are listed in section seven.

## 2. Theoretical framework

### 2.1. Development of the database

The accounting *database* has been the subject of major developments over the years. Companies in the US and UK were not required to compile financial statements in the nineteenth century (Watts, 1977:58). During this period many companies voluntarily compiled financial statements comprising a balance of profit and loss as well as a balance sheet. Some companies disclosed only partial financial information and many companies did not have proper records to substantiate the financial information disclosed. In order to address this deficiency pertaining to the quality of the accounting database a number of statutory bodies were introduced in order to regulate financial reporting, for example the Securities Exchange Commission (SEC) in the US, the Financial Reporting Review Panel in the UK and many other national monitoring bodies elsewhere (Sikka, 2001:200). The introduction of financial reporting regularity bodies did not necessarily result in a reliable accounting database as accounting regulation has also undergone major developments in recent times.

Even though IFRS was adopted by more than 100 countries, the convergence did not occur simultaneously. In 2002 the European Commission (EC) issued a regulation which required listed companies from member states to prepare financial statements in accordance with IFRS as of 1 January 2005. As a result the convergence to IFRS by European countries commenced in 2005 whilst others are planning to adopt IFRS in the near future, e.g. Brazil (2010), Canada, India, Japan and South Korea (2011). In like manner the SEC outlined a roadmap that will result in mandatory transition from US Generally Accepted Accounting Principles (US GAAP) to IFRS by 2014 (Deloitte, 2009b:1). Major obstacles are expected in these convergence efforts, for example, without even considering other countries, there are approximately 200 key differences between US GAAP and IFRS alone. US GAAP contain specific rules whereas IFRS are considered to be based on principles (Gorelik, 1994:95). In addition to these differences, a number of new IFRSs were introduced since the formation of the International Accounting Standards Board (IASB) in 2001. Over and above the 41 accounting standards developed from 1973 to 2001 by its predecessor, the International Accounting Standards Committee, the IASB

developed a further nine accounting standards from 2001 to 2009 (IASB, 2009:1; Sowden-Service, 2007:5).

It appears therefore that the database of the accounting environment may not only be incompatible between different countries due to different prevailing local accounting regulations but also inconsistent from year to year due to different convergence rates to IFRS as well as new developments in IFRS.

## *2.2. Accountability and accounting regulation*

Hope (2003:236) suggested that strong enforcement of accounting standards would improve the quality of financial reporting. The enforcement of accounting standards is, according to the EC, dependant on transparent corporate governance systems, auditing regulation, as well as independent institutional review (CESR, 2003:3). According to the SEC (2000:1) a high quality financial reporting environment is dependant on a combination of efficient reporting standards and active regulatory oversight. Despite the theoretical soundness of the regularity enforcement of accounting standards little evidence exists in connection with the effectiveness of the methods to monitor compliance of accounting standards.

Firstly, although certain countries might have systems in place to monitor compliance with prevailing accounting standards, they might not necessarily be able to monitor compliance with IFRS. The fact that, prior to the adoption of IFRS, accounting standards in many countries were rules-based might be more burdensome in practice. Furthermore, due to the fact that IFRS were only recently adopted in many countries little evidence exists in connection with the monitoring and regulation pertaining to the application of IFRS. Benston, Bromwich and Wagenhofer (2006:165) warned against inconsistent accounting practices when principles-based judgments are required to measure assets and liabilities. They also proposed a true-and-fair override requirement in order to address the inconsistent application of accounting principles. In addition, if accounting practises are burdened by the application of accounting principles the regulation of accounting principles should be even more difficult to achieve. Zeff (1995:54) highlighted difficulties experienced by accounting governing bodies to regulate principles-based terms, for example “fair presentation”. Moreover, Kershaw (2005:616) suggested that principles should not

be taken too seriously in the process of accounting regulation and concluded that the presence of principles will not necessarily get in the way of misleading financial information. It is therefore possible that principles-based IFRS might result in inconsistent accounting practices which will in turn also complicate the process of monitoring and regulating accounting practices.

In the second instance the monitoring function will be burdened by the diverse legal environments of countries across the globe. Daske, Hail, Leuz and Verdi (2008:2) suggested that the enforcement of IFRS will not be successful amongst countries with weak legal and enforcement regimes. Countries with stringent legal systems will therefore be more readily complying with IFRS which will in turn assist the process of monitoring compliance.

Thirdly, diverse levels of enforceability should be considered. Similar processes and practices will not necessarily be followed in the process of monitoring compliance with IFRS in different countries. The SEC will perform the monitoring function in the US, the EC will be entrusted with the function in Europe whilst the function can be conducted by securities regulators, stock exchanges or other mechanisms such as review panels in other parts of the world (Dao, 2005:108). In addition to dissimilar processes and practices, monitoring bodies from different countries might be entrusted with different levels of enforceability. Ball, Kothari and Robin (2000:4) argued that the extent to which accounting practices adhere to accounting standards varies internationally and that the incentive to follow accounting standards depends on penalties under different enforcement institutions. As a result penalties and fines for non-compliance with accounting standards may vary between countries.

We therefore suggest that the process of monitoring compliance with IFRS will be inconsistent between countries due to different processes and practices as well as different levels of authority to monitor compliance with IFRS.

### *2.3. SME reporting*

Even though Hope (2003:236) suggested that strong enforcement of accounting standards would also increase analysts forecast accuracy it is not clear whether he envisaged all types of businesses, especially the SME sector when making this statement. Levin and Travis (1987:30) advocated that the financial statements of SMEs tell only half the story about private companies.

The nature of SMEs (with limited investors) is substantially different than that of listed companies (with a variety of investors). The involvement of owner-managers do not warrant the same comprehensive effort by the directors to communicate financial information to multiple and diverse shareholders. Most SME owner-managers are already involved in the day-to-day operations of the businesses. Not only do they have regular access to the financial information, but they also consider certain financial information to be confidential. Khosrow-Pour (2006:954) suggested that issues of security and privacy are considered to be the main barriers in respect of SME research.

In addition the financial statements of SMEs are not necessarily utilised for budgetary and related forecast purposes as the principal role of SME financial reporting is retrospective and confirmatory in nature (Baskerville & Cordery, 2006:11). According to McMahon (1998:3) the financial information of SMEs is mainly utilised to evaluate the success of past decisions and in determining the present position. Furthermore, McCahey (1986:123) found that owner-managers are the primary users of SME statutory reports and that they do not necessarily have the ability to properly interpret them. Since the primary users of SME financial statements do not know how to interpret the information we suggest that the contents of the financial statements are also not the subject of a detailed analysis process. In the absence of detailed analysis of SME financial statements compliance with and the related enforcement of IFRS might not be a priority for accounting regulators. Moreover, Sian and Roberts (2009:302) found that, in addition to owner managers, tax authorities are the key recipients of SME financial statements. The likelihood that the contents and format of SME financial statements are influenced by the disclosure requirements of tax authorities, and not accounting regulators, can therefore not be ruled out. In conclusion evidence exists that the information needs of SMEs are very much different than the traditional IFRS audience.

#### *2.4. The South African context*

IFRS harmonisation in South Africa occurred from 1993 to 2004. During this period differences between South African Generally Accepted Accounting Practice (SA GAAP) and IFRS were eliminated. The legal enforceability of SA GAAP/IFRS however remained uncertain. As a result

legal backing for SA GAAP/IFRS was proposed as part of the corporate reform process (Vorster, Koornhof, Oberholster, Koppeschaar, Coetzee, Janse van Rensburg, & Binnekade, 2007:5; DTI, 2004:1). Non-legislative measures were in place for companies listed on the JSE Ltd in the form of the GAAP Monitoring Panel who monitors disclosure practices and related compliance with IFRS. In contrast disclosure practices of non-listed SMEs were not monitored to ensure compliance with SA GAAP/IFRS. Like their international counterparts the users of SME financial statements in South Africa will also not necessarily encourage compliance with SA GAAP/IFRS. In addition to the fact that the internal users of SME financial statements are also the owners of the business with regular access to the financial information, the financial statements of SMEs in South Africa may not always be up to date and readily available. Proper disclosure practices and compliance with accounting standards would also not necessarily address the requirements of external users<sup>14</sup>. Whilst the information needs of banking institutions and providers of finance are limited to liquidity ratios, the South African Revenue Service (SARS) is mainly concerned about taxable profits. The lack of interest by SARS in a complete set of financial statements is further supported by the fact that companies are no longer required to submit financial statements, but to submit only certain tax related information for tax filing purposes. Little evidence therefore exists that the disclosure practices of South African SMEs is in accordance with SA GAAP, IFRS or any relevant accounting framework. For this reason we suggest, based on the observations by Van der Tas (1988:158), that the harmonisation process of SME disclosure practices in South Africa were spontaneous and not necessarily influenced by the standard setting process.

### **3. Development of hypothesis**

Against the background of non-compliance with accounting standards by South African SMEs a reporting framework for the SME sector was introduced in August 2007. The exposure draft on IFRS for SMEs was adopted as the South African Statement of GAAP for SMEs without any

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<sup>14</sup> According to Collis and Jarvis (2000:12) banking institutions and tax authorities are the main external users of SME financial statements.

amendments to the exposure draft on IFRS for SMEs. The IASB, after considering additional feedback, adopted the exposure draft two years later. As from 2009 a global reporting framework for the SME sector will therefore be adopted by many countries. According to the IASB the IFRS for SMEs was developed to address the reporting needs of SMEs worldwide. In developing the IFRS for SMEs the IASB conducted a number of field tests to assess the relevance of the accounting standard in different countries which encompassed the restatement of a sample of SME financial statements in accordance with the IFRS for SMEs requirements (Pacter, 2009:30). Based on the above and in order to assess the relevance of the IFRS for SMEs in the South African context the following hypothesis can be formulated:

*H<sub>1</sub>*: In order to adopt an accounting framework for the SME sector it should be possible to restate SME financial statements in accordance with the disclosure requirements.

The above hypothesis was tested by comparing the illustrative financial statements of the IFRS of SMEs against information disclosed in the financial statements of SMEs in South Africa. This comparison might be an indication of the extent to which the IFRS of SMEs is applicable and acceptable to South African SMEs.

#### **4. Data and methodology**

The research encompassed both a literature and empirical study. The literature review considered the susceptibility of accounting standards to the SME sector. Our literature review revealed that the IFRS for SMEs was introduced despite the fact that compliance with accounting standards is not necessarily a priority of the SME sector, nor following a full review of reality.

Our empirical study was conducted to analyse the contents of a sample of financial statements compiled by South African SMEs and to compare the results to the IFRS for SMEs' illustrative financial statements and other relevant disclosure requirements. The research approach followed was a content analysis, which is a well-established research method used throughout the social

sciences (ACCA, 2009:18). Content analysis can be defined as a research technique for making replicable and valid inferences from text and related data (Krippendorff, 2004:18). In addition, although content analysis does not exclude quantitative research, the emphasis is more towards qualitative research. The focus is also on transferability, instead of generalisations, which usually limits the size of the sample (White & Marsh, 2006:36).

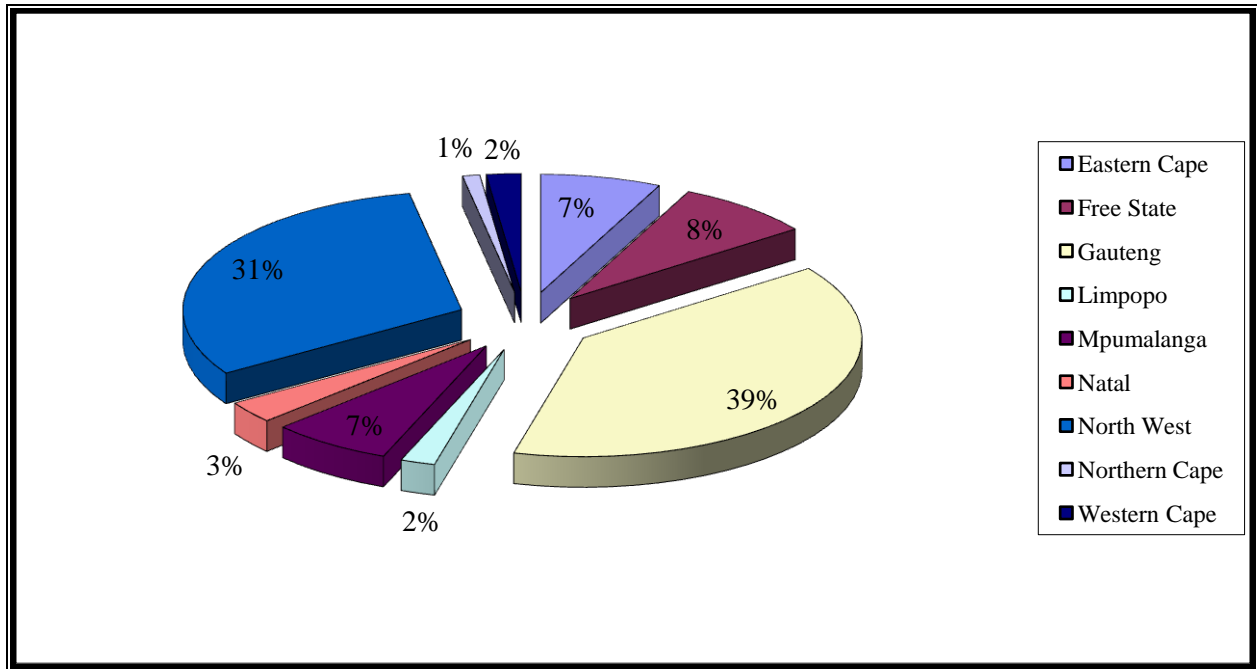
Although Ball and Foster (1982:167) found that many researchers, with accounting backgrounds, focussed on the development and adoption of IFRS by large industrialised countries, a number of researchers also considered the financial information included in the financial statements of entities, or the contents thereof. Bowman (1984:61) advocated that content analyses of financial statements represent a fine source of data of individual firms as well as for different industries. As far as the analysis of the contents of financial statements is concerned, Spathis (2002:179) attempted to develop a method to predict inaccurate financial statements from a sample of 76 Greek companies, Hernandez and Perez (2004:126) evaluated the relevant usefulness of the various sections of the financial statements from a sample of 54 credit institutions in Spain whilst ACCA (2001:17) constructed a disclosure index as a measure of the quality of disclosure practices for a sample of 57 UK firms. Christensen and Mohr (2003:148) examined the financial statements of US museums and compared the results to a random sample of 50 for-profit annual reports.

The contents of the IFRS for SMEs were also influenced by a number of field tests. The field tests, in general, encompassed compilation of financial statements in accordance with the IFRS for SMEs disclosure requirements. The IASB conducted a field test of 116 small entities from 20 different countries (Pacter, 2009:30). ACCA (2008:1) performed field tests of 25 companies in the UK. Their sample contained limited liability companies and one limited liability partnership ranging in sizes and sectors that are not publicly accountable. In Australia the IFRS for SMEs standard was field tested by two mid-tier medium-sized accounting firms, where each firm assessed the potential impact of the standard on the disclosure practices of three Australian entities. These entities included large proprietary companies, trusts and not-for-profit entities eligible to adopt the standard (CPA Australia and The Institute of Chartered Accountants in Australia, 2010:12).

IFRS for SMEs in the South African context is intended for companies and other entities that are neither listed companies nor financial institutions (Heffes, 2009:14). In contrast to the financial statements of listed companies the financial statements of SMEs were however not readily available. Where external users of SME financial statements are concerned research by Collis and Jarvis (2000:12) suggested that tax authorities and banking institutions are the main external users of SME financial statements. Since entities in South Africa are no longer required to include financial statements when filing tax returns a sample of financial statements could not be obtained from the South African tax authority. Banking institutions could also not be considered due to contractual restrictions to share client information with third parties. Furthermore, from the perspective of SME owners the collection of financial statements might have been encumbered by issues of security and privacy considerations (Khosrow-Pour, 2006:954).

Despite these constraints a sample of financial statements from the SME sector was collected from business owners in South Africa. In an attempt to include independent data a group of fourth year accounting students assisted with the collection process. Since the IFRS for SMEs, in the South African context, is intended for entities other than listed entities and financial institutions (Heffes, 2009:14), and owing to the fact that there is no central database available for the published financial statements of these entities, we were not aiming to include SMEs from specific industries, sizes or any other relevant classification. According to figure 1 below the sample size consisted of 100 financial statements from the SME sector. The financial periods ended in the 2008 calendar year and the majority of the financial periods ended on the last day of February.

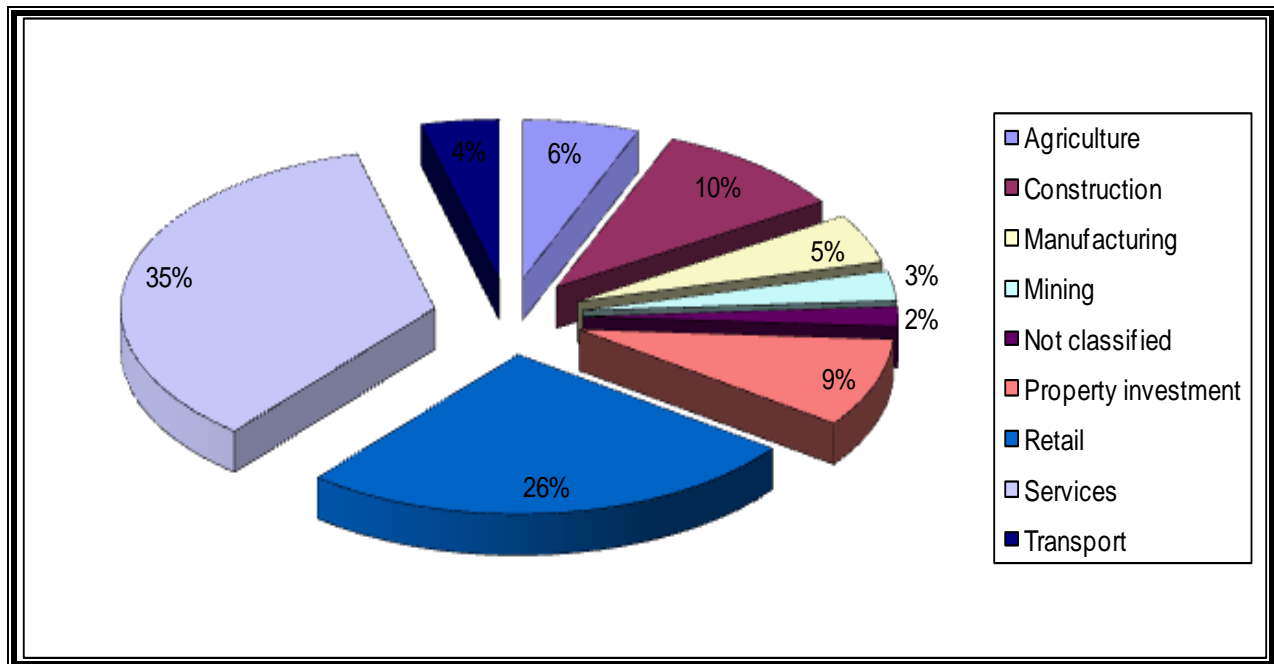
**Figure 1 – Classification of sample SME financial statements according to province**



The majority of the financial statements was from Gauteng (39%) and North West (31%). A possible explanation for this is the fact that Gauteng is described as the business mecca of South Africa. In addition to the fact that a large portion of South African businesses reside here, Gauteng is also a neighbouring province of North West where the majority of the students was based at the time of the sample.

Furthermore, as far as the business activities of the sample are concerned we noted that the majority of the sample financial statements was from the services and retail sectors in South Africa and only a limited number of entities from the mining, transport and agriculture sectors. Another two sets of financial statements from our sample did not provide any disclosure in connection with the nature or related business activities of the entity. The distribution of the sample according to business sectors is set out in figure 2.

**Figure 2 – Distribution of sample across business sectors**



The financial information of all the sampled financial statements was consolidated into a single statement of balance sheet and income statement<sup>15</sup> after which we compared the data to the relevant sections of the IFRS for SMEs' illustrative financial statements. In addition to the consolidated balance sheet and income statement our analysis also contained observations in connection with the statement of changes in equity, cash flow statements and notes to the sample financial statements. The consolidation incorporated firstly the balance sheets in table 1.

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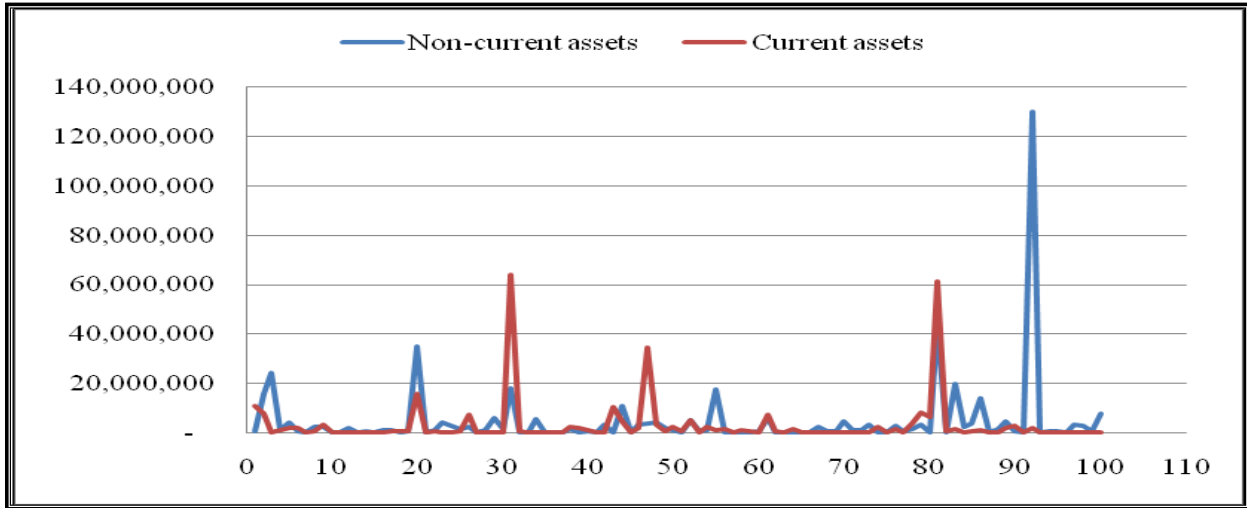
<sup>15</sup> The financial statements included in the sample were compiled for the 2008 financial period. Due to the fact that this period was before the effective implementation of IAS1 – Presentation of Financial Statements/Statement of GAAP for SMEs the terms "Balance Sheet" and "Income Statement" will be used in this study instead of "Statement of Financial Position" and "Statement of Comprehensive Income". Moreover, all the financial statements included in the sample contained the terms "Balance Sheet" and "Income Statement".

**Table 1 – Consolidated Balance Sheet**

	Sum of totals (South African Rand)	Percen- tage of items included in sample	Minimum amount disclosed	Maximum amount disclosed	Mean	Median	First quartile	Third quartile	Mean- centered coefficient of variance (COV)
<b>Non-current assets</b>	460,218,556								
Property, plant & equipment	180,648,079	87%	4,426	43,358,437	2,076,415	586,172	101,617	1,840,981	253%
Investment property	128,736,130	4%	1,261,918	103,500,000	32,184,033	11,987,106	2,237,108	41,934,031	150%
Goodwill	12,308,135	12%	75,000	5,077,090	1,025,678	355,611	143,439	797,710	159%
Investments	25,085,197	15%	50	11,851,103	1,672,346	51,000	22,901	255,747	219%
Loans receivable	108,364,582	46%	1,242	26,689,215	2,355,752	396,856	114,426	1,941,377	220%
Deferred taxation	5,076,433	14%	4,240	1,849,907	362,602	53,309	15,103	474,089	160%
<b>Current assets</b>	302,381,932								
Inventories	89,080,397	44%	3,983	26,898,690	2,024,554	373,576	105,425	1,251,005	251%
Trade and other receivables	167,943,035	72%	375	46,248,417	2,332,542	233,693	40,581	1,504,839	307%
Loans receivable	3,800,722	11%	3,789	1,383,890	345,520	240,000	116,530	390,631	117%
Current tax receivable	684,941	14%	4,510	149,867	48,924	28,429	9,217	75,295	103%
Cash and cash equivalents	40,872,836	79%	145	9,095,130	517,378	35,867	6,785	280,072	276%
	762,600,488								
<b>Equity</b>	91,286,610								
Share capital	8,130,598	99%	2	7,500,000	82,127	100	100	250	918%
Retained income	64,078,244	100%	-91,796,790	48,821,142	640,782	138,921	-44,355	837,562	1811%
Non-distributable reserve	19,077,768	11%	39,378	10,766,501	1,734,343	613,050	263,598	1,837,634	179%
<b>Non-current liabilities</b>	410,777,210								
Long-term liabilities	381,709,145	94%	506	93,289,204	4,060,736	952,388	447,557	2,274,136	302%
Deferred taxation	29,068,065	10%	17,009	14,923,198	2,906,807	355,751	72,750	3,170,149	174%
<b>Current liabilities</b>	260,536,668								
Bank overdraft	54,110,374	36%	3,363	14,233,203	1,503,066	121,760	30,638	905,223	209%
Trade and other creditors	171,087,730	88%	57	35,670,591	1,944,179	129,980	17,947	1,315,790	276%
Provisions	14,415	1%	14,415	14,415	14,415	14,415	14,415	14,415	N/A
Current tax payable	15,412,986	39%	112	3,926,468	395,205	84,966	20,597	399,553	194%
Deposits	1,033,927	2%	33,927	1,000,000	516,964	516,964	275,445	758,482	132%
Income received in advance	494,153	1%	494,153	494,153	494,153	494,153	494,153	494,153	N/A
Short-term loans	18,383,083	21%	17,154	8,776,993	875,385	328,678	80,206	678,822	215%
	762,600,488								

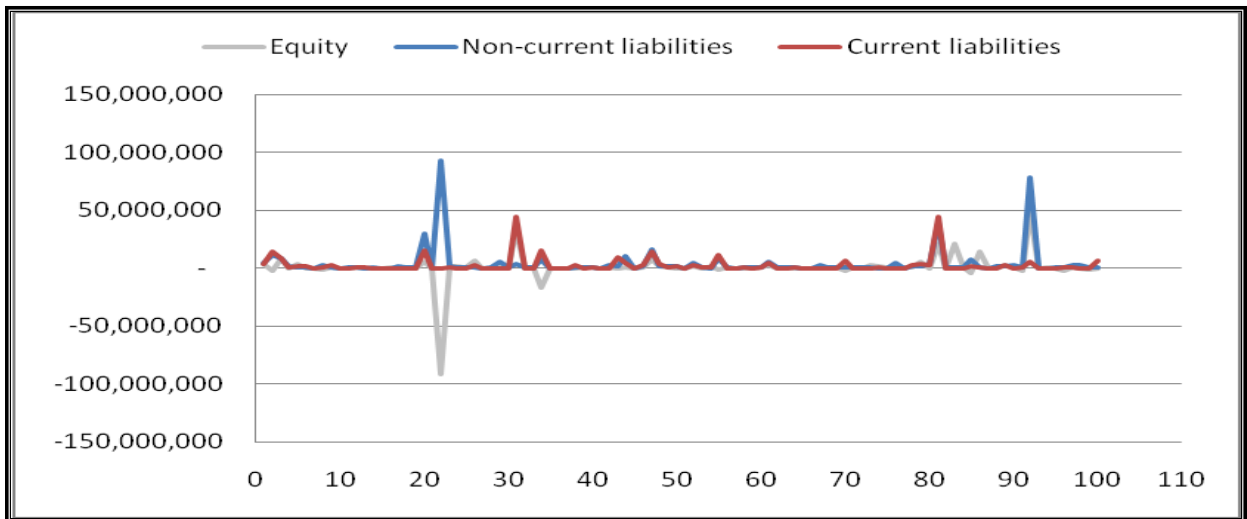
The distribution of the data in table 1 implies a fairly high degree of variability in connection with the financial data included in the sample. This variance was also supported by coefficients of variances in excess of 100% for individual line items included in the consolidated balance sheet. The dispersion of the financial data relating to non-current assets and current assets included in table 1 is summarised in figure 3 (Y axis presented in R-value).

**Figure 3 – Analysis of assets included in sample**



The dispersion of financial data relating to equity, non-current liabilities and current liabilities included in table 1 is presented in figure 4.

**Figure 4 – Analysis of equity and liabilities included in sample**



Following the consolidated balance sheet the consolidated income statement is presented in table 2. Similar to the financial data contained in table 1 the variability of the financial data pertaining to the consolidated income statement was also high, or unevenly distributed. Other income included an individual amount of R36,1 million and based on the information disclosed in the

sample financial statements we could not summarise other income into a different and more meaningful subcategory.

**Table 2 – Consolidated Income Statement**

	Sum of totals (South African Rand)	Percentage of items included in sample	Minimum amount disclosed	Maximum amount disclosed	Mean	Median	First quartile	Third quartile	Mean- centered coefficient of variance (COV)
<b>Income</b>	1,371,700,511								
Sales	1,296,629,746	83%	16,400	230,729,801	15,622,045	2,420,683	810,415	12,396,190	237%
Rental income	11,174,785	9%	8,350	6,579,953	1,241,643	114,035	20,000	263,158	190%
Investment income	7,927,844	52%	1	4,417,117	152,459	6,200	161	69,241	407%
Discount received	3,503	1%	3,503	3,503	3,503	3,503	3,503	3,503	N/A
Other income	55,964,633	44%	8	36,063,853	1,271,923	67,543	19,209	284,008	433%
<b>Expenditure</b>	1,287,548,883								
Cost of sales	852,808,895	60%	3,234	163,363,757	14,213,482	2,221,706	464,410	12,438,800	213%
Operating cost	408,527,355	97%	1,308	47,135,937	4,211,622	786,364	176,814	3,312,421	214%
Finance charges	26,212,633	72%	44	7,345,089	364,064	58,758	10,447	176,649	279%
<b>Profit before taxation</b>	84,151,629								
<b>Taxation</b>	28,860,565	75%	-1,849,907	9,123,198	384,808	9,828	-	170,910	350%
<b>Profit for the period</b>	55,291,064								

Ninety eight percent of SMEs included statements of changes in equity, the only movement in equity for all the financial statements included in the sample however represented net profit or loss after taxation for the financial year and since this amount is included in the income statements it was decided not to consolidate the statements of changes in equity. We also decided to omit cash flow statements due to the fact that only 61% of the sample contained cash flow statements. The lack of cash flow information for certain entities might therefore distort any meaningful consolidation in this regard. In addition we analysed the notes to the sample financial statements in table 3. The accounting policy notes are firstly presented in panel A.

**Table 3: Notes to the Consolidated Financial Statements – Panel A**

	Number of items included in the consolidated financial statements	Number of items included in the notes to the consolidated financial statements	Items included in the notes as a percentage of items included in financial statements
<b><u>Accounting Policy Notes</u></b>			
Property, plant and equipment	87	71	82%
Investment property	4	3	75%
Goodwill	12	2	17%
Financial instruments	100	23	23%
Inventories	44	26	59%
Provisions	1	8	> 100%
Impairment of assets	0	7	> 100%
Revenue recognition	83	53	64%
Borrowing cost	94	11	12%
Employee benefits	97	1	1%
Foreign currency translation	1	2	> 100%
Leases	74	7	9%
Taxation	75	36	48%

Our analysis in panel A revealed that the sample financial statements contained accounting policy notes for 13 different sections in the financial statements. The number of items included in our sample is presented in column 1 whereas the percentage of accounting policy notes in relation to the sections included in our sample is presented in column 3. The sections in column 3 in excess of 100% (provisions, impairment of assets, and foreign currency translation) implies that accounting policy notes were disclosed even though the relevant section was not included in the financial statements.

Secondly our analysis in panel B provides a summary of additional information disclosed in the notes to the sample financial statements. These notes provide, in addition to accounting policy notes, supplementary information in connection with the balances and totals disclosed in the balance sheets and income statements.

**Table 3: Notes to the consolidated financial statements – Panel B**

	Number of items included in the consolidated financial statements	Number of items included in the notes to the consolidated financial statements	Items included in the notes as a percentage of items included in financial statements
<b><u>Notes to the Consolidated Balance Sheet</u></b>			
<b>Non-current assets</b>			
Property, plant and equipment	87	87	100%
Investment property	4	3	75%
Goodwill	12	5	42%
Investments	15	12	80%
Loans receivable	46	41	89%
Deferred taxation	14	10	71%
<b>Current assets</b>			
Inventories	44	24	55%
Trade and other receivables	72	40	56%
Loans receivable	11	2	18%
Current tax receivable	14	0	0%
Cash and cash equivalents	79	23	29%
<b>Equity and liabilities</b>			
Share capital	99	69	70%
Retained income	100	6	6%
Non-distributable reserve	11	0	0%
<b>Non-current liabilities</b>			
Long-term liabilities	94	84	89%
Deferred taxation	10	10	100%
<b>Current liabilities</b>			
Bank overdraft	36	11	31%
Trade and other creditors	88	38	43%
Provisions	1	1	100%
Current tax payable	39	5	13%
Deposits	2	0	0%
Income received in advance	1	0	0%
Short-term loans	21	21	100%
<b><u>Notes to the Consolidated Income Statement</u></b>			
Revenue	83	24	29%
Cost of sales	60	5	8%
Depreciation	97	8	8%
Accounting fees	97	3	3%
Employee costs	97	4	4%
Finance charges	72	18	25%
Taxation	75	45	60%

Our analysis revealed that the majority of the notes relate to the balance sheet and that a smaller number of information disclosed in the notes to the sample financial statements is applicable to the income statement.

With regards to the consolidated balance sheet a number of different terms was used to describe the amounts disclosed in the sample financial statements, for example trade creditors, trade payables and accounts payable. In addition to inconsistent descriptions several different formats were used for the income statements. Some income statements were classified by nature whilst others were classified by function. A number of entities included condensed income statements as opposed to detailed income statements. As a result it was not possible to include details of operating costs in the consolidation. Expenses were therefore classified into three different categories namely cost of sales, operating costs and finance costs. Furthermore, the three main categories in the consolidated income statement are income, expenditure and taxation.

Finally our discussion covered the content and different formats of the financial statements included in our sample against the IFRS for SMEs' illustrative financial statements.

## **5. Results**

### *5.1. Consolidated Balance Sheet (table 1)*

Consolidated assets exceeded consolidated liabilities by R91 million. Amounts disclosed as assets in the sample financial statements were between R50 for investments and R103,5 million for investment property. With reference to figure 3 a total number of four SME financial statements contained non-current assets in excess of R20 million comprising investment property (R21,4 million and R103,5 million) as well as property, plant and equipment (R43,4 million). Three of the financial statements selected contained current assets in excess of R20 million including inventories (R26,9 million) as well as trade and other receivables (R36,9 million and R46,2 million). In like manner only a few individual amounts from figure 4 were in excess of R20 million, including long-term liabilities (R29,5 million, R93,3 million and R63,4 million), retained income (R33,1 million, R20,8 million and R48,8 million), retained deficit (R91,8

million) as well as trade and other creditors (R28,1 million). Property, plant and equipment (87% of the sample), cash and cash equivalents (79% of the sample) as well as trade and other receivables (72% of the sample) were the main types of assets included. Investment property was included by only four entities ranging from R1,2 million to R103,5 million with an average amount of R32,1 million per entity. A limited number of financial statements however contained goodwill (12%). Despite a retained loss of R91,7 million for an individual SME the consolidated retained income amounted to R64 million. Furthermore, 34% of the sample financial statements contained retained losses amounting to R135 million in total. Equity items were limited to share capital (99% of the sample), retained income (100%) and non-distributable reserves (11% of the sample). Liabilities were mainly long-term loans (94% of the sample) along with trade and other creditors (88% of the sample). With regards to current liabilities provisions (1% of the sample), deposits (2% of the sample) and income received in advance (1% of the sample) were not frequently disclosed items. With reference to figure 3 and in addition to the aforementioned retained loss of R91,7 million a total number of five SMEs reported retained income under equity in excess of R20 million, A total number of four SMEs disclosed non-current liabilities in excess of R20 million while only two financial statements included in our sample contained current liabilities in excess of R20 million. As far as taxes are concerned many SMEs disclosed taxes receivable/payable separately from trade and other receivables/payables. Current tax receivable comprised 14% of the sample whilst 39% of SMEs disclosed current tax liabilities in their balance sheets. The combined total of 53% of our sample that disclosed current tax liabilities as separate items in the balance sheets could be significant if the assessed losses of many SMEs are also taken into account. On the contrary deferred taxation was not a common attribute as only 14% of the entities included deferred tax assets whilst deferred tax liabilities were included by 10% of the sample.

## 5.2. Consolidated Income Statement (table 2)

The consolidated profit after tax amounted to R55 million and contained profits from 65 entities (65% of sample). The remaining 35% of the sample generated losses for the period under review ranging from R175 to R16,1 million. Profits included in the sample were between R1,708 and

R25 million. Most SMEs included sales (83% of the sample) as income and operating costs (97% of the sample) as expenses. A large number of SMEs incurred finance costs (72% of the sample) and income tax (75% of the sample) in the income statements.

### *5.3. Notes to the Consolidated Financial Statements (table 3)*

Even though the extent to which notes were included in the financial statements was summarised in table 3, the detail from the notes to the sample financial statements was not consolidated as part of this study.

Firstly, we noted that a small number of SMEs disclosed accounting policy notes. In contrast to approximately 31 different types of accounting policy notes for listed companies (Deloitte, 2009a; PriceWaterhouseCoopers, 2009) the sample contained only 13 different types of accounting policy notes. Without taking into account the amounts disclosed in the financial statements, a relative small percentage of SMEs included accounting policy notes in their financial statements. Property, plant and equipment (71% of total sample) as well as revenue recognition (53% of total sample) were the only two types of accounting policy notes included by more than fifty percent of the sample. Accounting policy notes in connection with property, plant and equipment were limited to depreciation methods and periods and those applicable to revenue provided more information about revenue recognition criteria. If accounting policy notes are linked to items disclosed in the financial statements the following notes which provided additional information in connection with policies applied were in excess of fifty percent: Property, plant and equipment (82% of the sample), investment property (75% of the sample), revenue recognition (64% of the sample), and provisions (800% or 8 accounting policy notes and 1 item disclosed as provisions in sample financial statements).

Secondly, notes other than accounting policy notes pertaining to non-current assets in the balance sheet were, except for goodwill (42%), included by the majority of the SMEs included in our sample. Seventy five percent of the SMEs included in our sample disclosed supplementary information for property, plant and equipment, investment property, investments, loans receivable, deferred taxation, long-term liabilities and short-term loans in the notes to the financial statements. Inventories (55%) and accounts receivable (56%) were the only two types

of current assets in excess of fifty percent. A higher number of notes were also included for non-current liabilities compared to current liabilities. Under current liabilities provisions (100% of the sample) and short-term loans (100% of the sample) were in excess of fifty percent. Additional information was also disclosed for share capital (70% of the sample) whilst no notes were included for non-distributable reserves (0%) under equity in the balance sheets.

Thirdly, we observed that a low percentage of SMEs disclosed notes to the income statement. The only significant income statement items for which additional information was disclosed in the notes thereto were revenue (29%) and taxation (60%).

#### *5.4. Illustrative Financial Statements*

When comparing our consolidated balance sheet with the IFRS for SMEs' illustrative financial statements we noted that all the entities in our sample should include current assets/liabilities before non-current assets/liabilities. Although in a different sequence, the consolidated balance sheet could be converted into the illustrative financial statements with relative ease. Investments, investment property and loans receivable were non-current assets included in our sample that are not included in the illustrative financial statements. Due to limited disclosure in this regard it was not possible to distinguish between investments in subsidiaries, investment in associates, financial assets, or any other relevant classification.

None of the financial statements from our sample contained liabilities in the form of interest payable and employee obligations. In contrast, deposits and income received in advance were included in our sample as liabilities whereas these items did not appear in the illustrative financial statements. Furthermore, long-term liabilities were not categorised in different classes in the individual balance sheets included in the sample. For this purposes it was therefore necessary to divide long-term liabilities in sub-categories.

**Figure 5 – Analysis of long-term liabilities included in sample**

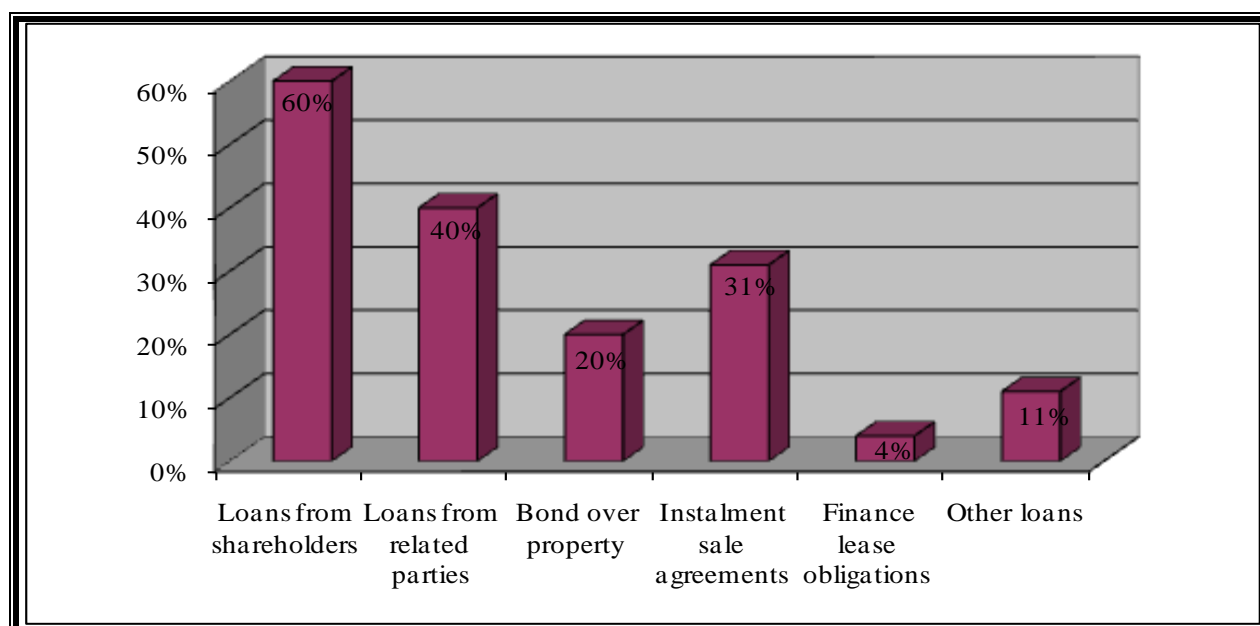


Figure 5 suggests that our sample financial statements included different types of long-term liabilities than those included in the illustrative financial statements. The majority of the long-term liabilities was classified as either loans from shareholders (60% of the sample contained loans from shareholders), loans from related parties (40% of the sample) or instalment sale agreements (31% of the sample). A small percentage (4% of the sample) of SMEs included finance lease obligations. Furthermore, R223,8 million or 59% of the total value of long-term liabilities in table 1 represented unsecured loans from shareholders and related parties compared to 40% secured loans amounting to R153,5 million. Eight different loans, or 1% of the long-term liabilities in value terms, did not contain any disclosure as to whether loans are secured or not.

It appears as if the conversion of the income statements from our sample to the illustrative financial statements would be more burdensome than the balance sheet. Our sample consisted of both detailed and condensed income statements. The comparison of the financial statements in our sample was also complicated by the inclusion of income statements classified by nature and by function. Limited guidance is given in connection with other income as well as the distinction between the different types of revenue. Moreover, none of the income statements in our sample classified operating costs as distribution cost, administration expenses and other expenses.

Instead, in addition to SMEs disclosing detailed income statements, a number of different classifications was used to group expenses together. Clear guidance in connection with the classification of operating costs was also not provided in the illustrative financial statements. In conclusion we noted that the majority of the SMEs included in our sample disclosed movements in retained income in the statement of changes in equity, as opposed to the income statement, and that these movements were limited to profits or losses pertaining to a financial year.

## **6. Discussion and conclusion**

Based on our literature review we found that the regulation of IFRS compliance is inconsistent between countries owing to inconsistent processes, practices as well as levels of authority and enforceability. Moreover, it appears that the monitoring of compliance with IFRS will be more acceptable to countries with politically and legally stable environments. In addition to differences in accounting regulation our literature review revealed key differences between SMEs and listed companies. Owing to these differences a number of IFRS requirements are not necessarily applicable to the SME sector.

Our sample confirmed the diverse nature of SMEs in South Africa. Retained income was between R92 million in losses and R49 million in profits with share capital ranging from R2 to R7,5 million. We observed that 34% of the entities reported retained losses. None of the entities however accounted for impairment losses or related expenses in connection with discontinued operations and activities. Furthermore, none of the SMEs disclosed any limitations to continue as a going concern. The absence of these items might be indicative of the close relation between the SME management role and SME ownership. Under most circumstances SME managers and SME owners are inseparable. Due to the fact that SME owners have regular access to financial and related information we suggest that SME owners also have updated information about operational and financial challenges and in contrast to listed companies SME owners/shareholders do not have to wait until impairment losses, going concern problems and related items are communicated by management in the form of the financial statements. Our observation in connection with the close relation between SME owners and SME management is further supported by a significant number of shareholders' loans (60%) included under non-

current liabilities. Moreover, the majority of these loans were unsecured and interest-free with no fixed terms of repayment. The fact that SME owners are willing to finance the activities of SMEs by means of unsecured and interest-free loans provides even more support about the close interaction with owners.

Our study revealed a further noteworthy difference between listed companies and SMEs. Unlike listed companies that often generate substantial funding through the listing process it appears that SMEs do not issue share capital for purposes of raising funds. The share capital of the majority of the SMEs (89%) amounted to R1,000 and less. Compared to an average amount of R4 million disclosed for long-term liabilities the results suggest that activities are mainly financed by means of raising debt as opposed to share capital. Further support for this observation was found in the statement of changes in equity. The only changes in equity represented accounting profits or losses for the year. The absence of dividends paid suggests that investors do not invest share capital in SMEs on which they expect a return in the form of dividends.

In addition to internally generated loans from shareholders and related parties our study revealed that the majority of external loans comprised instalment sale agreements (31%) secured by underlying assets. The fact that the main type of external finance was obtained through instalment sale agreements might be indicative of the fact that providers of finance to the SME sector are mainly concerned with the condition of the underlying assets as opposed to proper disclosure of other items included in the financial statements. The relevant importance of non-current and other related assets was further emphasised by the fact that the majority of the sample financial statements contained property, plant and equipment (87% of the sample).

Evidence that SME financial statements were compiled to address the information needs of tax authorities could be found in the fact that income taxes receivable and income taxes payable were disclosed separately from trade and other receivables/payables. A large number of SMEs also disclosed income taxes (75% of the sample) in the income statement. A small percentage of SMEs however disclosed deferred tax. Our study therefore provided evidence in connection with disclosure practices to address the needs of the two main types of external users of SME financial statements, as identified by Collis and Jarvis (2000:12).

Our research suggests that fair value accounting is not popular amongst South African SMEs. A

small percentage of SMEs accounted for revaluations. Non-distributable reserves were disclosed by 11% of the sample whilst none of the entities disclosed additional information in connection with non-distributable reserves in the notes to the financial statements. Moreover, we observed that the majority of financial assets, for example investments, are carried at cost.

Despite the fact that a number of entities included rental income in the income statements only a small percentage of SMEs classified property as investment property (4% of the sample). The practise of separating investment property from other types of property could therefore not be verified for the SME financial statements included in our sample.

Even though 15% of our sample contained investments, none of the entities compiled consolidated financial statements. Due to limited disclosure in this regard we were also not able to ascertain whether these SMEs are required to prepare consolidated financial statements. In the absence of consolidated financial statements the inclusion of goodwill by 12% of our sample appears to be abnormal. Our analysis in table 3 also revealed that limited disclosure was provided in connection with goodwill.

A limited amount of information was also disclosed in the notes to the financial statements. Less than 50% of the accounting policy notes pertaining to listed companies was included in the sample. It also appeared that the notes provided a mere summary of balances and totals disclosed in the balance sheet or income statement. Only 61% of the sample financial statements contained cash flow statements whereas disclosure in the statements of changes in equity was limited to profits or losses. In view of the fact that the illustrative financial statements include movements in retained earnings or accumulated losses on the face of the income statement, the relevance of the statement of changes in equity in the South African context might not be certain.

Finally our study revealed that the IFRS for SMEs' illustrative financial statements could be adopted without much difficulty. We found that all the main categories from the sample balance sheets and income statements were covered by the illustrative financial statements. Based on the results the hypothesis cannot be rejected. It is therefore suggested that the IFRS for SMEs could become the preferred accounting framework for SMEs in South Africa.

## **7. Limitations and future research recommendations**

Owing to the fact that our sample contained a sample of 100 SME financial statements the results might not be representative of all SMEs and other South African entities planning to adopt the IFRS for SMEs. The sample size could however favourably be compared to similar studies and more specifically the field tests conducted by the IASB.

Another limitation could be the fact that we did not involve practitioners and preparers of these financial statements. Our analysis was limited to the information disclosed in the financial statements.

Due to these limitations we recommend that future research should involve the classification of entities required to adopt and apply IFRS for SMEs into different groups and sectors as well as the analysis of financial statements prepared in accordance with the IFRS for SMEs. We also recommend that the views of preparers and users of these financial statements are considered when analysing SME financial statements prepared in accordance with the IFRS for SMEs.

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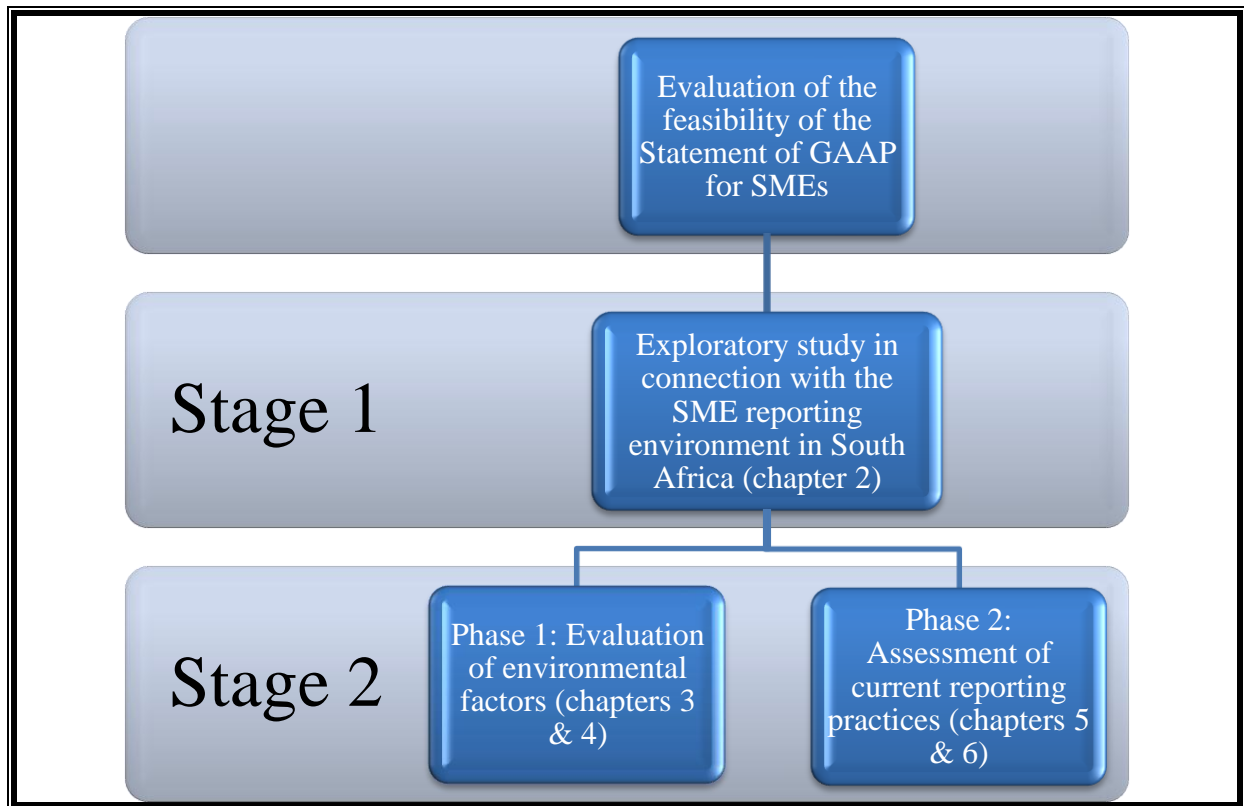
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## **CHAPTER 7 – Summary, limitations and recommendations**

### **1. Introduction**

The purpose of this chapter is to draw conclusions from the five research articles that formed part of this study. Conclusions are drawn in accordance with the research objectives. The objectives comprised an evaluation of: i) the unique nature and attributes of SMEs; ii) the main differences between large/listed entities and SMEs; iii) the implications when global accounting standards are adopted by the SME sector; iv) the relevant environmental factors influencing the SME accounting environment; v) the relevance of the contents of the Statement of GAAP for SMEs against the practices of the preparers of financial statements; and vi) the extent to which the proposed contents of the newly adopted Statement of GAAP for SMEs are included in the financial statements compiled by South African SMEs. These objectives were derived from the main problem statement (chapter 1, page - 4 -) where the question was asked to what extent the South African equivalent of the IFRS for SMEs, entitled the Statement of GAAP for SMEs, will be viable in the South African context. As a result the overall study considered the feasibility of the Statement of GAAP for SMEs in the South African context. A feasibility study is defined as an evaluation of a proposal designed to determine the difficulty in carrying out a designated task (American Heritage Dictionary of the English Language, 2000). In other words, a feasibility study is an evaluation of the potential impact of a proposed project, or an attempt to determine the likelihood that a proposed product or development will accomplish its objectives. Generally, a feasibility study precedes technical development and project implementation. In light of the evidence the announcement of the Statement of GAAP for SMEs could very well be described as a proposed project. At the time of the empirical study, South Africa has adopted the IFRS for SMEs even though it was still in draft format. Furthermore, very few South African SMEs have adopted the framework for their financial reporting purposes. The potential impact of the Statement of GAAP for SMEs was therefore assessed against possible environmental factors affecting SMEs in South Africa as well as an assessment of the contents against current reporting practices. Figure 1 below provides a summary of the study.

**Figure 1 – Research summary**



The overall study was conducted in two broad stages. Firstly an exploratory study regarding the SME reporting environment of South African SMEs was conducted in chapter 2 (research article 1, page - 19 -). The second stage consisted of a further two phases. The first phase considered environmental factors related to SME reporting and were researched in chapter 3 (research article 2, page - 52 -) and chapter 4 (research article 3, page - 92 -). The second phase considered the current reporting and disclosure practices of SMEs in South Africa and were completed in chapter 5 (research article 4, page - 123 -) and chapter 6 (research article 5, page - 165 -).

Moreover, limitations of this study are also discussed and recommendations are made in connection with formal accounting standards for an informal SME sector. Finally, further potential research opportunities that emanated from this study are presented.

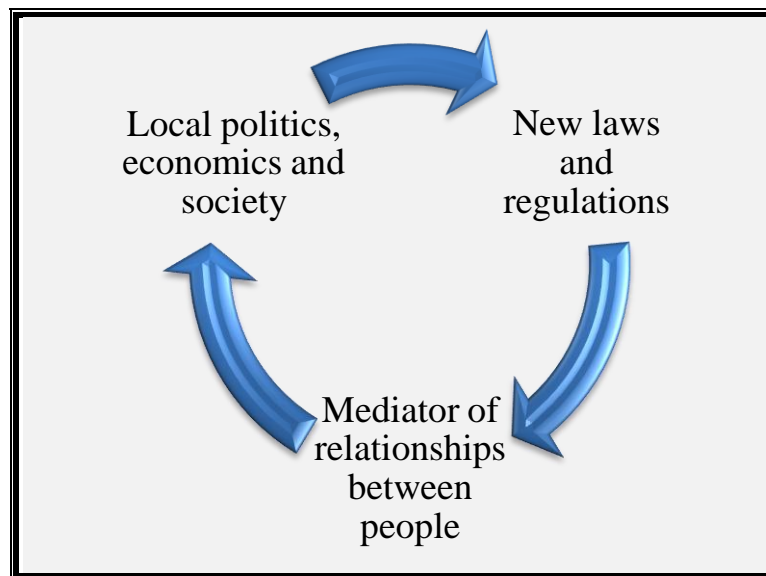
## 2. Discussion and conclusions

### 2.1. *The announcement of global accounting standards*

The impact of globalisation in today's business environment cannot be denied. The integration of national economies into a global economical order is considered a direct consequence of improved communication methods, technological developments as well as the liberalisation and deregulation of markets (Dreher, Sturm & Ursprung, 2008:263; Goyal, 2006:166). The accounting environment was also affected by the "globalization" phenomenon and, as a result, a single set of global accounting standards, formally known as International Financial Reporting Standards (IFRS), was developed to enable accountants to measure financial information and disclose such data to a global audience including managers, investors, tax authorities and other decision makers.

The adoption of a global set of accounting standards could in essence be seen as the implementation of a new law or regulation. The successful implementation of any law or regulation is dependent on a proper evaluation thereof prior to its enactment. Even though the evidence suggests that the International Accounting Standards Board (IASB) normally follows rigorous processes to ensure that feedback is obtained from accounting stakeholders prior to the announcement of new accounting standards, reports of inconsistent IFRS applications by different countries occurred in recent times. Countries experienced difficulties in preparing for the implementation of IFRS and the training and education of IFRS principles in some countries were delayed. A key contributory factor to such delays and problems is the fact that IFRS was developed to address the needs of global role-players and multinational companies, whereas in individual countries the laws and regulations are shaped by local politics, economics and society (Held, McGrew, Goldblatt & Perraton, 1999:10; Somers, 1993:587). Laws serve as a primary social mediator of relations between people within a specific country, whereas IFRS address the interaction of international stakeholders participating in the global financial world. The development process of new laws and regulations is illustrated in figure 2.

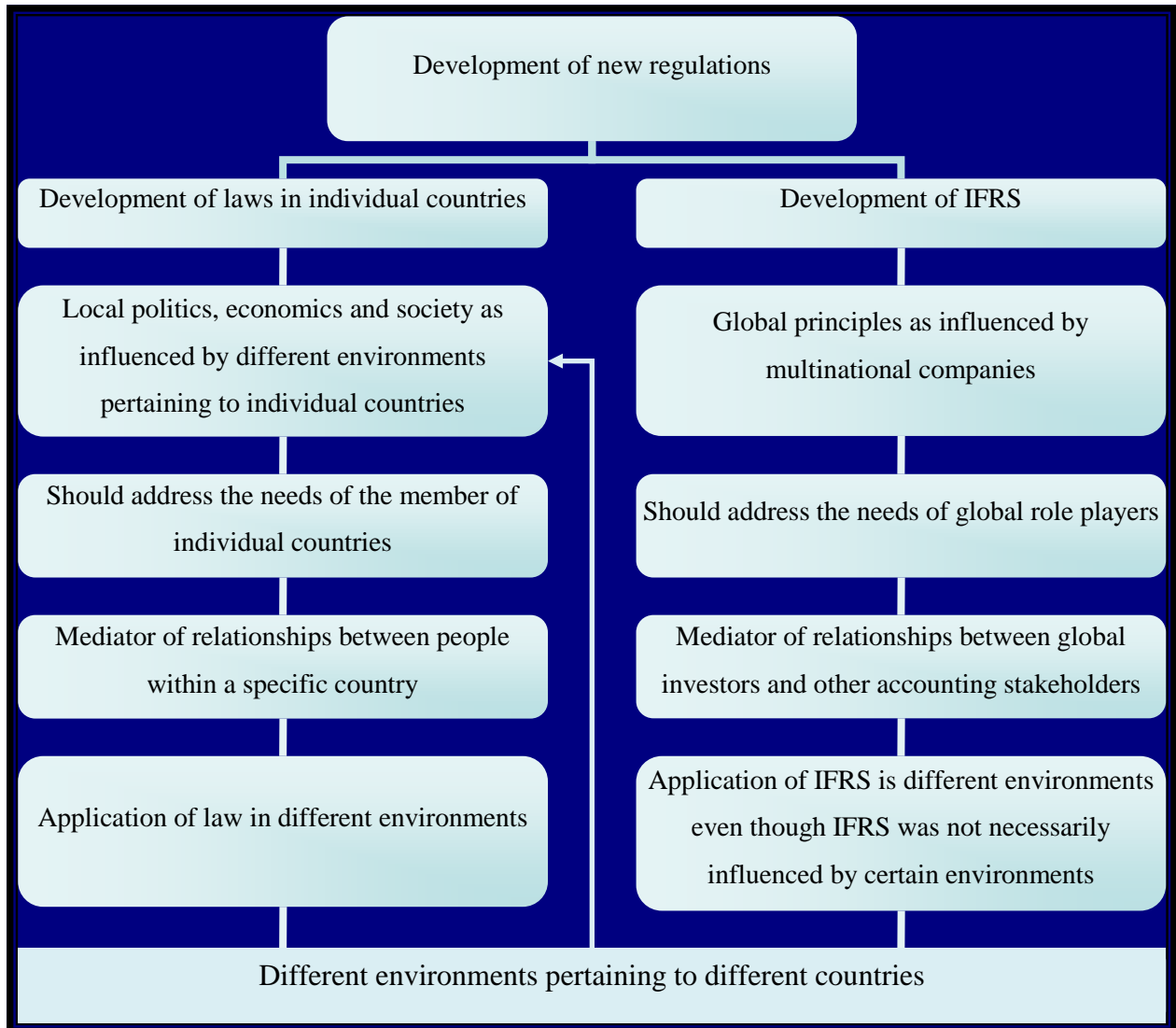
**Figure 2 – Development of new laws and regulations**



(Source: Own research)

Accountants are however not only confronted by diverse legal environments. Research revealed that the accounting environment is influenced by a multitude of environmental factors, such as culture, history, geography, alternative socio-economic and political systems, legal and taxation systems, professional governing bodies, religion, language and education. The impact of environmental factors on the accounting environment is further supported by the statement that accounting is a product of its environment. As a result the development of laws and regulations compared to the development of IFRS can be summarised as follows:

**Figure 3 – Development of laws and regulations versus development of IFRS**



(Source: Own research)

According to figure 3 the objective of IFRS is to address the informational needs of a multitude of global role-players. It could therefore be argued that the global accounting phenomenon is confronted by i) its objective to serve the needs of the participating global stakeholders and ii) the application of identical accounting practices in dissimilar environments.

## *2.2. Identification of most relevant environmental factor*

Culture is considered to be one of the most important environmental factors. Researchers considered the impact of cultural differences on accounting stakeholders, including professionals, academics, trainees, students and regulators. It is therefore evident that the accounting environment, including development, education, application and regulation, is believed to be influenced by cultural differences. Based on the aforementioned this study revealed measurable cultural differences amongst accounting students within South Africa as well as between South African accounting students and those in the United Kingdom (UK). The decision to include accounting students was based on i) the fact that they were not influenced by prior non-IFRS accounting practices as well as ii) the fact that they were generally from the same age group. The study utilised the Hofstede Value Survey Model to determine cultural dimensions after which Gray's accounting values (an extension of Hofstede's cultural dimensions) were assigned to the accounting students included in the study. Firstly, from the perspective of adopting prescriptive accounting standards the following accounting values were deemed to be important (refer to chapter 3, page - 81 -):

- Statutory control in order to adhere to a single set of prescribed rules and regulations in connection with accounting transactions and related disclosure thereof;
- Uniformity, irrespective of different backgrounds, in order to apply uniform accounting practices and principles; and
- Transparency in order to be open and publicly accountable.

From the analysis the study revealed that black accounting students from previously disadvantaged backgrounds in South Africa and to a lesser extent white South African accounting students, favour statutory control and uniformity whereas transparency is more relevant to the UK accounting students. Secondly, the contents of IFRS are not necessarily prescriptive in nature. The literature suggests that a number of IFRS-related inconsistencies between countries are attributable to the fact that accounting standards in certain countries are rules-based whereas IFRS is based on principles. If the concept of principles-based accounting

practices is added to the equation the following accounting values are considered to be important:

- Professionalism in order to apply professional judgment to specific scenarios;
- Flexibility in order to adapt to individual situations and specific scenarios; and
- Transparency for purposes of public accountability.

The analysis revealed that the principles contained in IFRS should be more acceptable to accounting students in the UK due to a preference for all three of the above. In contrast, the South African students, and specifically black accounting students, will find it more difficult to deal with principles-based accounting standards. Cultural differences were therefore identified as a key environmental factor affecting the accounting phenomena and that cultural attributes considered necessary to adopt a prescriptive set of accounting standards may not be consistent with the requirements considered necessary to successfully adopt principles-based IFRS. As a result it was revealed that IFRS should be more acceptable to accountants from the UK whilst accountants from South Africa will find it more difficult to cope with IFRS due to an absence of Gray's professionalism, flexibility and transparency values.

### *2.3. The impact of cultural differences on the SME reporting environment*

During the globalisation efforts of IFRS, many governments recognised the importance of small and medium entities. The importance of SMEs as role players in many economies was realised and as a result a number of initiatives were introduced internationally to provide support to small businesses. IFRS however, did not necessarily address the informational needs of SMEs and simplified accounting procedures were called for. Furthermore, the cost to comply with IFRS outweighed the benefits for SMEs. Moreover, the accounting function was listed as a key constraint of SMEs and blamed for many SME failures worldwide. As a result the IASB announced accounting regulations for the SME sector entitled the IFRS for SMEs. The main objective of the IFRS for SMEs was to ensure a high quality, understandable and enforceable accounting standard for the SME sector.

In South Africa the government acknowledged the fact that the SME sector was neglected and also introduced a number of initiatives to assist SMEs. These initiatives were introduced to ensure sustainable and equitable growth in the South African SME context. During this time, despite the fact that the IFRS for SMEs was still in draft format and not adopted elsewhere, South Africa was the first country to formally adopt the IFRS for SMEs as the Statement of GAAP for SMEs. However, the process of adopting the IFRS for SMEs in the UK appeared to be not that straight forward. Not only did it take five years to adopt the IFRS for SMEs in the UK, but the contents were also heavily criticised as still being too complicated. Additional comments received by the IASB during this period included: i) the fact that IFRS for SMEs are not comparable between different countries, ii) the fact that fair value accounting is not applicable to SMEs, iii) the fact that IFRS for SMEs are applicable to larger SMEs, iv) more simplifications were asked for and v) the fact that the common informational needs were not considered and addressed.

In addition the study revealed that as a business concern, the typical SME does not have a global focus. Unlike multinational companies with an international focus it was found that a small percentage of SMEs is global and that SMEs' involvement in international business is limited to exporting to economies that are geographically and culturally close. The informal nature of SMEs was apparent and supposedly burdensome. Although a degree of formality is required to regulate accounting practices, SMEs are informal in nature and formalities are considered to restrict the entrepreneurial flair of SME owners. SMEs comprise a variety of sizes due to the fact that SMEs from different parts of the world are based on inconsistent definitions and classifications. Moreover, many SMEs from different parts of the world may not be involved in the same industries. Lastly, data relating to the SME sector is often unreliable with no central public database.

Based on distinct characteristics concerning SMEs a third set of accounting values is considered important when adopting i) prescriptive accounting standards, ii) based on principles, iii) for the SME sector in many different countries:

- Professionalism in order to adapt to various scenarios due to diverge nature of SMEs as

well as different classifications worldwide;

- Flexibility in order to swiftly adapt to market conditions;
- Secrecy due to the informal nature of SMEs and limited use of financial statements.

The results suggest that the concept of uniform accounting standards for the SME sectors should be more suitable to accounting students from the UK due to a preference for professionalism and flexibility.

To summarise it was found that cultural differences play an important role when different countries from different parts of the world adopt accounting standards and that South Africans in particular will be confronted by their preference for statutory control and uniformity when adopting accounting standards for the SME sector.

#### *2.4. The role of the SME accountant*

The first phase of this stage considered the possible impact of environmental factors on the adoption of accounting standards by the SME sector (chapter 3 on page - 52 - and chapter 4 on page - 92 -). The objective of chapter 3 was to identify relevant environmental factors influencing the accounting environment. The objectives of chapter 4 were to consider the unique nature and attributes of SMEs, to identify differences between large entities and SMEs as well as to identify specific SME environmental factors.

The assessment was based on feedback obtained from accounting students. In addition to accounting students other accounting role players consist of practising accountants as well as accounting regulators. When the Statement of GAAP for SMEs/IFRS for SMEs was announced accounting practitioners were, in contrast to accounting students, exposed to and influenced by customary and prevailing accounting practices pertaining to the SME sector in South Africa. As a result the focus shifted to an assessment of the contents of the Statement of GAAP for SMEs against current practices as well as the role of the external accountant within the SME reporting environment.

The research revealed that SMEs do not have effective in-house accounting functions and are therefore very much dependent on external accountants (Also refer to the high level summary of findings in Annexure A). Furthermore, in contrast to large and listed companies where accountants serve the interests of external shareholders, the primary relationship is between the accountant and the SME owner-manager. The managerial role that SME owners fulfil also affects the informational needs of SMEs and, as a result, the communication of financial information by SME accountants. The involvement of owner-managers suggests that they already have access to certain financial information whilst other information might be considered confidential. In further support of alternative informational needs by SMEs it was revealed that SME owners rely on computer programs to make financial decisions and that SME financial statements are conformity in nature only. Moreover it was found that SME financial statements are not always up to date and readily available whilst SME owners do not know how to interpret the financial statements presented to them. The study revealed that SME accountants cannot charge their clients more for technically correct financial statements and that a tax saving carries more weight than comprehensive disclosure practices. Finally, based on feedback obtained from SME accountants it was revealed that external users of financial statements are mainly banking institutions as well as tax authorities with alternative information needs compared to the traditional IFRS audience.

#### *2.5. The role of accounting regulators*

Owing to the fact that the Statement of GAAP for SMEs was only recently introduced the regulation of the accounting standard in the South African context could not be evaluated. It was nevertheless revealed that the legal and regularity environment in which SMEs operate is a concern to the South African government. Even more, until recently no legal backing existed for accounting standards in South Africa. A survey conducted amongst SME accountants revealed that they find it difficult to interpret financial statements compiled by colleagues and that proper guidance from accounting regulators and accounting standards are considered to be important and necessary. A noteworthy number of SME accountants however did not provide any comments in connection with the development and adoption of the Statement of GAAP for

SMEs. It was also revealed that the IASB received a small number of comments from developing countries, including South Africa and other African countries. In the absence of the regulation of accounting standards pertaining to SMEs it was concluded that SME disclosure practices in South Africa were spontaneous and not necessarily influenced by the standard setting process.

## *2.6. Disclosure practices by SMEs*

Due to the distinct nature of SMEs, the related emphasis of external accountants and in view of the earlier conclusion reached that SMEs disclosure practices were not necessarily influenced by the standards setting process, the practices by SME accountants in the South African context was assessed in phase 2 (chapter 5 on page - 123 - and chapter 6 on page - 165 -). The objectives of chapter 5 were to identify preparers of SME financial statements, to determine the reporting requirements from the perspective of the preparers of SME financial statements, to evaluate the background, perceptions and mind-set of the preparers of SME financial statements in connection with compliance of accounting standards and to evaluate the relevance of the contents of the Statement of GAAP for SMEs against the practices of the preparers of financial statements. The objective of chapter 6 was to determine the extent to which the proposed contents of the newly adopted Statement of GAAP for SMEs are included in the financial statements compiled by the South African SMEs.

Firstly, the contents of the Statement of GAAP for SMEs/IFRS for SMEs were evaluated by practising accountants. Secondly, financial statements from South African SMEs was analysed to evaluate whether the illustrative financial statements contained in the Statement of GAAP for SMEs/IFRS for SMEs would be acceptable to South African SMEs. The study revealed that a number of SMEs in South Africa do not compile cash flow statements and that a limited amount of information is disclosed in the notes to the financial statements. Although the practitioners indicated that accounting policies, changes in estimates and correction of errors are highly important none of the sample financial statements contained notes in this regard.

The statements of changes in equity revealed that changes in equity comprise movements in profits/losses only. With regards to the statements of comprehensive income/income statement it

was revealed that the sampled SMEs do not account for government grants, share-based payments, foreign currency translation, segment reporting and discontinued operations while the majority of the financial statements contained revenue, leases, employee costs and income taxes (except for deferred tax).

In the case of the statement of financial position/balance sheet, the study revealed that the sampled SMEs do not hold the majority or significant investments in other entities, nor do they enter into joint ventures and business combinations. SMEs do not account for investment properties, intangible assets, assets held for sale and impairment of assets. In contrast property, plant and equipment, financial assets and liabilities and inventories are typical SME components. SMEs do not disclose any provisions and contingent liabilities as well as events after the reporting period. Only one of the three specialised industries activities were included by SMEs in South Africa. Agriculture was included to a limited extent whereas extracting activities (mining) and service concessions were not included at all and also not considered important by the practitioners who participated in this study.

Based on the aforementioned it was concluded that only five components relating to specific transactions included in the Statement of GAAP for SMEs was considered to be less important, namely hyperinflationary economics, foreign currency translation, share-based payments, extracting activities and service concessions. Apart for a different sequence of certain items disclosed as well as different sub-classifications (for example long-term liabilities), it also appears that it would not be that difficult to convert the financial statements compiled by SMEs in South Africa to the illustrative financial statements contained in the Statement of GAAP for SMEs/IFRS for SMEs.

Based on the fact that the first phase (chapters 3 and 4) revealed i) cultural differences within South Africa as well as between South Africa and the UK, ii) the possible influence of cultural differences when reporting standards are adopted on a global basis and despite the fact that iii) some of its contents is considered not applicable, the overall hypothesis as defined on page - 7 - is not rejected.

The evidence from the second phase (chapters 5 and 6) however suggests that the majority of the

contents of the Statement of GAAP for SMEs are acceptable to SME accountants. Furthermore, a comparison between the illustrative financial statements and current reporting practices did not reveal major differences. Based hereupon the overall hypothesis is rejected and it is therefore suggested that the Statement of GAAP for SMEs might be feasible in the South African context.

### **3. Limitations**

Within the limited scope of this research project, it is possible to identify certain limitations the reader should be cognisant of when considering the results. Firstly, the analysis of cultural differences within the South African context considered white Afrikaans-speaking accounting students and black accounting students with previously disadvantaged backgrounds. South Africa is considered to be a multi-cultural society, it is therefore possible that other cultural dimensions might also be of relevance, for example Asian and white English-speaking students.

Secondly, due to inconsistent classifications of SMEs worldwide the analysis of financial statements included in chapter 6 might not be comparable to similar studies in different countries. It is for example possible that a larger entity in the South African context is classified as a smaller entity in the United States. Some of the findings might therefore only be transferable to certain SMEs in the South African context.

### **4. Recommendations for future research**

Considering the above-mentioned limitations, future studies might consider other cultural classifications as well as perspectives in other countries. The research revealed distinctive cultural patterns within South Africa as well as South Africa compared to the UK. It is recommended that cultural dimensions from other countries are also determined to evaluate the impact of cultural differences on the implementation of IFRS for SMEs on global basis. Finally, it is recommended that similar criteria to classify SMEs worldwide is adopted as well as more regular analyses of SME financial statements in order to evaluate the feasibility of IFRS for SMEs on an international level.

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