

Why Differential Reporting is Important for Small and Medium sized Entities in Mongolia?

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Abstract

Small and Medium Sized Entities (SMEs) play an important role in the global economy. Little is known however, about what the needs of information users of SMEs; who benefits from their financial statements; what the main factors to comply with international reporting standards. The main objective of the paper is to highlight the importance of differential reporting, its global trend, reporting needs of SMEs; and the IFRS for SMEs (International Financial Reporting Standard for Small and Medium sized Entities).

Keywords: accounting standard, differential reporting, IFRS, IFRS for SMEs, SMEs

Introduction

Mongolia is one of the early economic and political reformers compared with other transitional economic countries. The country's accounting and auditing reforms began in 1993 with assistance from the United Nations Development Programme and the World Bank with the introduction of the double entry accrual accounting system in State Owned Enterprises (Asian Development Bank, 2005). Since 1993, the World Bank and other international organizations have provided financial and technical support to develop accounting education, a legal framework, and the adoption of the International Financial Reporting Standard (IFRS). The government

of Mongolia decided early on in favour of international reporting standards rather than a nationally specific accounting system. Mongolia formally adopted the IFRS in 1993.

SMEs are key players in the economy of Mongolia. Small entities have a significant influence on the economy. However, very little is known about the financial reporting practices of SMEs from Mongolia. This article presents the differential reporting necessity in the country by highlighting the importance of small entities in economy, the need and global trend of differential reporting including the future impacts of the IFRS for SMEs in Mongolia.

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What is the role of SMEs in economy of Mongolia?

The vast majority of the world's companies are privately owned SMEs. Hence, SMEs are often considered the backbone of any country's economy (Jarvis, 2002; Sian, Roberts, 2006). In common with other countries of a similar population size, the economy of Mongolia is dominated by SMEs. The country adopted the "SME Act" for the first time in 2007. The Act defines SMEs as those having less than 199 full time and contracted employees and up to 1.5 billion tugrug (0.6 million USD) in annual sales. However, this definition varies from sector to sector because of its economic scale and significance.

The World Bank noted that by the end of 2013, SMEs make up nearly 98 percent of all enterprises in Mongolia and their contribution to GDP remains low at 25 percent (IFC, 2014). Furthermore, SMEs are known to be significant providers of employment in Mongolia. In 2005, SMEs employed nearly 300,000 employees and produced 1.8 percent of annual budget revenue (Ministry of Food and Agriculture of Mongolia, 2009). Hence, the majority of SMEs belong to micro entities and remain small both in terms of revenue and employment. In terms of employment, statistical data showed that close to 90 percent of total SMEs reported having less than ten employees (National Statistical Office of Mongolia, 2007). Only 3.9 percent employ more than 50 workers (Battsetseg, 2008).

Why SMEs need differential reporting framework?

Differential reporting describes the idea that different entities should be subject to different accounting rules (Jarvis, 2002). Differential

reporting is the best solution for reducing the accounting standards overload problem of SMEs (Lungu, Caraiani, Dascalu, 2007; Shannon, 1992; Sian, Roberts, 2006, 2008). Research into the differential reporting of SMEs has increased remarkably over the last 30 years. This widespread interest has been the result of several factors, including an increasing recognition of reporting differences between publicly listed open companies and privately held closed small companies and the different information needs of users. The main purpose of differential reporting is to develop small entities within a reliable accounting framework, and to make reporting more cost-effective for financial information preparers and users (Pacter, 2004a).

Universally, standard setters have taken great consideration of the need for simplified, differential reporting after recognizing the reporting burden on small entities. Standard setters are also concerned about global comparability and reliability of SME accounting information (Allee, Yohn, 2009; Beuselinck, Manigart, 2007; Carsberg, Page, Sindall, Waring, 1985; Friedlob, Plewa, 1992; Maingot, Zeghal, 2006; Page, 1984; Sealy-Fisher, 2006; Sian, Roberts, 2008; The Institute of Chartered Accountants in Australia, 2007; Williams, Tower, 1998).

Global trend of differential reporting

The case for differential reporting has been articulated and to some extent practised, from time to time in different countries. The differential reporting framework in the UK is called Financial Reporting Standard for Small Entities. The country developed that standard and applied it in practice in 1997. The main motivating factors of this standard were reduced disclosure, decreased reporting burdens, compliance costs and ease of

use for smaller entities. Another well-known model of the differential reporting system was implemented in New Zealand in 1994. If an entity is SME then it does not need to comply with certain reporting requirements in New Zealand.

In the first time, in September 2003, the IASB surveyed national standard setters about the current SME reporting practice in various countries and the need to have a separate set of standards for SMEs (Pacter, 2004b). As a result of the survey, the 30 standard setters that responded said that the IASB should develop global standards for SMEs. After six-years of active development, in July 2009, the IASB issued the IFRS for SMEs, which are estimated to represent more than 95 percent of all companies. The IFRS for SMEs is a self-contained standard of about 230 pages on the needs and capabilities of

smaller entities (IASB, 2009). According to the IASB, this standard responds to strong international demand from both developed and emerging economies for an accurate and common set of accounting standards for SMEs that is simpler than full IFRS (IASB, 2009).

Does new IFRS for SMEs make any difference?

After official publication of IFRS for SMEs, a number of national jurisdictions have adopted or are planning to adopt the new standard. Recent adopters are Iran, Kazakhstan, and Montenegro that bringing the total adopters to 150 (IFRS Foundation, 2017). The IFRS Foundation reported that the use the IFRS for SMEs standard in those jurisdictions is different as summarised in Table 1 (IFRS Foundation, 2017).

Table 1. Global adoption of the IFRS for SMEs

	Number of Jurisdictions
IFRS for SMEs Standard is required or permitted	85
IFRS for SMEs Standard is currently under consideration	11
IFRS for SMEs Standard is not used or under consideration	54
Total	150

In addition, the IFRS for SMEs Standard was adopted without any modifications in 78 of the 85 jurisdictions that require or permit the Standard. According to adopters' opinion, the main benefits of this standard provides improved comparability for users of accounts, and enhances overall confidence in the accounts of SMEs. Most importantly, they believe that the differential reporting standard for SMEs reduces the significant compliance costs with international standards.

However, there are some debates about new IFRS for SMEs regarding the appropriateness of the standard. A single set of SME reporting

standards may not be relevant to all countries (Bailey, 1995; Cui, Evans, Wright, 2007). The reason is the different nature of SMEs in both developed and emerging economies means that it could be necessary to develop a relevant standard for their countries. For example, the biggest enterprise in an emerging country is equivalent to a relatively small enterprise in a developed country (Confederation of Asian and Pacific Accountants, 2003). The turnover of SMEs is measured in millions of dollars in developed countries, even though that would be considered too large in emerging countries (Sian, Roberts, 2006). For example, SMEs employ fewer than 250 employees in

Europe; in the UK small entities have fewer than 50 employees; most manufacturing and mining industries should have fewer than 500 employees or USD \$0.75 million of annual turnover for most agricultural industries in order to still be considered small entities in the USA.

However, in the case of Mongolia, statistical data shows that 90 percent of entities have less than 20 thousand US dollars in annual sales revenue and employ less than 10 employees. Hence, different economic environments at different rates of development mean that a “one-size-fits-all” approach may not be appropriate for every nation.

Conclusion

IFRS are developed primarily from industrialized countries. Therefore, countries need to examine the appropriateness of this differential reporting standard to SMEs including Mongolia by providing empirical evidence. In order to do that, a number of future studies need to address the current IFRS compliance level, reporting burden, and the practical problems of SME reporting in Mongolia. In particular, cost and benefits of complying with the full IFRS, and anticipated benefits and additional costs of complying with the new IFRS for SMEs are should be the main interests of future studies in Mongolia.

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