

# An SME Financial Reporting Standard for Singapore

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## **An SME financial reporting standard is expected to be ready by mid-2007. Do you think there is a need for SMEs to have a different accounting standard?**

The recent CCDG (Council of Corporate Disclosure & Governance) issuance of the IASB's (International Accounting Standards Board) discussion paper in Singapore has provided a lot of interest into the subject matter.

While there are merits and minuses regarding this issue, conceptually, we are of the view that the existing standards may contain excessive disclosure requirements for SMEs based on a cost-benefit analysis. Based on our credit research and advisory experience, we believe that SMEs generally have fewer resources, limited access to capital markets, less business complexity and fewer external users of its financial statements, compared to say, larger listed companies.

We believe that users of financial statements of SMEs will be more interested in current liquidity and short-term cash flows than long-term forecasts of cash flows and earnings. Interest coverage and related party transactions are also areas of concern for smaller companies.

### **If a standard is imposed, how will this affect SMEs?**

One major interest of SMEs would be to reduce the cost of preparing financial statements. For this purpose, the IASB has and will be introducing simplifications in presentations and disclosures, and recognition and measurement procedures. IASB has also stated that "any modifications to concepts or principles must be on the basis of the identified needs of users of SME financial statements and cost/benefit analysis.

Nonetheless, regardless of how and when the accounting standards will be implemented, SMEs will need to be more familiar in terms of several key areas like revenue recognition, differences in treatment of expenses and capital expenditure, the issue of intangible assets like intellectual property rights as well as the gain and loss arising from their assets or investments. These are the important areas that have direct bearings on a firm's true and underlying profitability, solvency, liquidity and efficiency.

Failure to understand these would possibly place the firm at a more disadvantaged position as they may be trapped into believing that their figures are "real" or in the worst scenario, get in the wrong side of the law. While the business owners are not expected to know 100% of the accounting regime or procedures, understanding the broad strokes, together with having a professional to advice them on the implication these have on the business is most recommended. Business owners will then be freed to focus on more on planning their corporate and business strategies and manage their resources from top-down approach. This will result to a more successful business over the longer term.

Having understood the general merits of separate accounting standards for SMEs, the risks or downside of implementing separate standards for SMEs would be:

1. There may be a lack of uniformity, transparency and clarity in the financial reports;
2. There would not be meaningful comparison and benchmarking among companies;
3. Some SMEs may have complex transactions and inter-company holdings;
4. Approximately 80%-90% of an Asian economy, and therefore the effect of a change in reporting standards may have significant implications to the overall spending (CAPEX) and profitability levels;

Certain smaller-sized entities are already exempted from audit in many countries including Singapore, and therefore, having a separate set of simplified accounting standards for SMEs may be perceived as an erosion of the importance of financial reporting.