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Nadia Albu, Catalin Nicolae Albu

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STRATEGIES FOR AND IMPLICATIONS OF THE IFRS FOR SMES IMPLEMENTATION IN EMERGING ECONOMIES

Nadia Albu, Associate professor of accounting
Bucharest Academy of Economic Studies, Romania
Faculty of Accounting and Management Information Systems
6 Piața Romană, sector 1, București, 010374
Tel: +40 21 319 1900/365, Email: nadia.albu@cig.ase.ro

Cătălin Nicolae Albu, Associate professor of accounting
Bucharest Academy of Economic Studies, Romania
Faculty of Accounting and Management Information Systems
6 Piața Romană, sector 1, București, 010374
Tel: +40 21 319 1900/365, Email: catalin.albu@cig.ase.ro

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Abstract

IASB issued in 2009 the IFRS for SMEs to address the need for international comparability in terms of financial reporting by SMEs. The purpose of this paper is to discuss possible IFRS for SMEs implementation scenarios and implications in emerging economies, using the case of Romania as an illustrative example. We provide insights regarding the role of accounting and accountants, the users and their interests, and the expectations regarding the future reforms of the accounting model around this implementation. We argue that the most preferable approach of implementation in emerging economies should focus on convergence and should emphasize continuous education of the accounting profession and of the business environment.

Keywords: IFRS for SMEs; emerging economies; role of accountants; interests; convergence

Résumé

L'IASB a émis en 2009 l'IFRS pour les PME pour accroître la comparabilité des informations financières publiées par celles-ci. L'objectif de cet article est d'analyser les potentiels scénarios d'implémentation de l'IFRS pour les PME et leurs implications dans les économies émergentes, en utilisant le cas de la Roumanie en guise d'illustration. Nous analysons en détail le rôle des comptables et de la comptabilité, des utilisateurs et leurs intérêts, et les attentes concernant les futures réformes du système comptable autour de cette implémentation. Nous soutenons que l'approche d'implémentation que s'avérerait la plus préférable devrait se centrer sur la convergence et la formation continue de la profession comptable et du milieu entrepreneurial.

Mots clés: IFRS pour les PME; économies émergentes; rôle des comptables; intérêts; convergence

1 Introduction

The financial reporting models of emerging economies exhibit both similarities with and differences from those in developed economies. Generally, these models underwent several reforms, being modeled after one or more models of developed countries, and especially after the European Directives (hereafter ED) (in Europe) and International Accounting Standards/International Financial Reporting Standards (hereafter IAS/IFRS), but their particularities strongly affect the way in which the accounting model is operated. Consistent with its intent to address the need for international comparability in terms of financial reporting by SMEs, International Accounting Standards Board (hereafter IASB) issued in July 2009 the International Financial Reporting Standard for Small and Medium-sized Entities (hereafter IFRS for SMEs) (IASB, 2009).

While the countries with strong accounting traditions probably build their strategy regarding the IFRS for SMEs implementation on their national experience, it is argued that a lesser resistance to adopting IFRSs might be encountered in countries not having such traditions (Sellhorn and Gornik-Tomaszewski, 2006). Also, some (Sellhorn and Gornik-Tomaszewski, 2006) argue that many Less Developed Countries (hereafter LDCs) (for example, new European Union members) drove their financial reporting models towards IFRSs (as a benchmark or as a starting point for national standards) in order to increase the relevance and the reliability of the financial statements issued. Also, IFRS implementation is regarded as a legitimization act (Irvine, 2008), because it “could affect a country’s reputation as modern, organized and well-regulated place to do business” (Jermakowicz and Gornik-Tomaszewski, 2006, p. 191). But on the other hand some (Chand, 2005; Rodrigues and Craig, 2007) underlined that developing countries should not adopt standards before evaluating the associated costs and benefits.

In this context, the IFRS for SMEs implementation provides new opportunities for research (Nobes, 2010), being of great interest for researchers, practitioners and regulatory bodies. The purpose of this paper is therefore to discuss the possible IFRS for SMEs implementation scenarios and implications in emerging economies, using the case of Romania as an illustrative example. Using interviews with the main actors involved in the accounting process and the analysis of the accounting reforms and accounting practices, we provide insights into the accounting context of emerging economies regarding the role of accounting and accountants, the users and their interests, and some expectations regarding the future reforms of the accounting system. Our paper contributes to an understanding of the particularities of accounting in different emerging economies, stakeholders’ expectations, and the role of the IFRS for SMEs and of accounting education for the economic development of such countries.

The paper is organized as follows. In Section 2 we review the literature on IFRS implementation and accounting for SMEs at the European Union level and in the context of emerging economies. Section 3 sets forth our methodology and section 4 presents our research findings. Finally, our conclusions and research limitations are presented in Section 5.

2 Literature review

The process of accounting convergence and the issues related to the implementation of IFRSs worldwide are topics of much interest recently for standard setters, researchers, practitioners and professional bodies. Also, this subject is of interest borderless, since IFRSs tend to become the main set of standards (at least for capital markets) at the international level, and to influence national standards and regulations globally.

The national characteristics, i.e. each country's accounting culture and traditions, have emerged over (a long) time in close relationship with the political, social and economic environment of each of them, influencing the way in which IFRSs are applied. Factors such as the role of the State, the type of legal system in place, the preferred providers of finance, the relationship between accounting and taxation, the culture, or the role of the accounting profession significantly impact accounting practices (Alexander et al., 2006; Nobes and Parker, 2008). Also, previous research indicated that the lack of political will, rooted in local culture and a strong national outlook prevent a truly harmonized accounting framework (Callao et al., 2007, p. 149); that a magnitude of differences exist between countries and high costs to eliminate them exist (Jermakowicz and Gornik-Tomaszewski, 2006); that local traditions exercise a strong influence on the implementation of new concepts (as previously noted on "true and fair view" for example, see Sucher and Jindrichovska, 2004), and that tax and legally-based orientation hinder the harmonization process (Larson and Street, 2004; Vellam, 2004).

Consequently, literature builds some strong arguments for IFRSs implementation, but also documents that caution needs to be exercised in this process (referred to and explained as *thesis* and *antithesis* by Rodrigues and Craig, 2007). While research on the application of IFRSs is already available, a lot of research still needs to be done in order to understand all the mechanisms of accounting change and resistance to change around this process, and how different economic and cultural contexts react to IFRSs. The movement towards convergence requires research to provide updated assessments of convergence and impediments to its progress (Meek and Thomas, 2004, cited in Larson and Street, 2004, p. 95). We contribute to this issue by providing evidence from an emerging economy on the need for accounting information prepared in compliance with IFRS for SMEs, by investigating in-depth the national context and perceptions of different actors involved in the accounting process.

In Europe, full IFRSs are required for more than 8,000 listed companies while the majority of companies are unlisted SMEs and mostly follow national standards, thus not providing a satisfactory level of international comparability (of course, regulations based on the Fourth and Seventh Accounting European Directives are alternatively followed). Jermakowicz and Epstein (2010) referred to the case of EU as now having 55 different SME GAAPs (referring to Pacter, 2009). In this context, the possibility of the IFRS for SMEs application in EU is analyzed.

In 2010, a consultation was carried on by the EU in order to gain insights from different countries about their position on the issue of the IFRS for SMEs application. More than 200 answers were received, with mainly less than 10 per country (except for Germany, 56) (EC 2010). The results indicated divergent opinions between countries, and between categories of respondents within the same country. The responding preparers show an opposition to the IFRS for SMEs, while users are favorable to the standard (EC, 2010; Quagli, 2010). The

inclusion of the IFRS for SMEs in the European Directives, the modernization and simplifications of Directives were indicated by respondents as envisageable solutions. In 2011, the European Commission published the proposal for the modernization of the European Directive for SMEs, specifying that “Mandatory adoption of the IFRS for SMEs is not being pursued as a policy within this proposal”, one of the arguments being that “IFRS for SMEs is a relatively new standard” and “experience with its implementation worldwide was still lacking” (EC, 2011, p. 7). However, the EU members might still consider IFRS for SMEs as a benchmark for the modernization of their accounting systems.

Worldwide, at least 67 jurisdictions have either adopted or affirmed their commitment to do so in the immediate future (Brice, 2011). For the time being, United Kingdom proved its agreement towards the IFRS for SMEs implementation, and also countries such as South Africa, Guyana, Panama or Sierra Leone also require or allow the IFRS for SMEs at least for some entities (www.iasplus.com). Turkey also decided that IFRS for SMEs will be applied starting with 2012 (Albu et al., 2011b).

In many EU countries, financial reporting is linked to taxation, which is inconsistent with IASB’s philosophy and raises issues for an accurate IFRSs application, and especially that of the IFRS for SMEs. The application of the IFRS for SMEs will imply breaking the traditional bond between financial statements and the income tax return (Jermakowicz and Epstein, 2010), which makes countries such as France or Germany oppose this standard. On the other hand, many LDCs that became ‘new’ EU members have oriented their accounting model towards IFRSs (Sellhorn and Gornik-Tomaszewski, 2006), but they cannot be viewed as a homogeneous block because of their different approaches to accounting reform. Rodrigues and Craig (2007) underlined that these countries should adopt standards which are relevant and useful for them and assess the costs and benefits before making a decision.

The IFRS for SMEs is considered to be “a significant development which may have strong impact on accounting and auditing practice in the future, but the attitude of national regulators and standard-setters is crucial in establishing the limits of this possible impact” (Jermakowicz and Epstein, 2010). EU’s decision is very important, and the EU and/or national jurisdictions will require or allow the IFRS for SMEs or will consider a convergence plan with this standard. Earlier, Sellhorn and Gornik-Tomaszewski (2006, p. 199) argued that “Due to diversity in size, complexity of operations and ownership structure, it is efficient to allow each firm to assess for itself whether the benefits of IFRS adoption outweigh the costs.” Nobes (2010) suggested that the EU should allow member states to exempt most private companies from the application of the 4th European Directive, and this would ease the adoption of the IFRS for SMEs in these countries. Each of these scenarios has advantages and disadvantages, which might also be country-contingent.

More, a possible implementation needs to be analyzed from a classification standpoint too. Quantitative criteria are used within the EU to classify entities and differentiate between their reporting obligations. On the other hand, size should not be the determining factor in establishing the scope of the IFRS for SMEs application¹ (Carfang, 2010).

¹ IASB avoided any reference to quantitative criteria when discussing the scope of the IFRS for SMEs. When initial discussions emerged (even in the issued Exposure Draft), IASB has used the term “small and medium-sized entities” in order to define scope, with no particular (and deliberate) reference in the definition to any quantified size criteria, a view which is consistent with the body’s principle-based approach (BCED 43). In 2008, the term SME was replaced with “Private entities” in response to the comment letters, field tests and

Considering all of these, we will provide evidence from an emerging country about the perception of main stakeholders concerning the need for information based on the IFRS for SMEs at the national level. Also, we will deal with the way in which the national context might influence the cost and benefits of the IFRS for SMEs implementation, and will discuss the criteria to be used in order to decide the entities that will fall under the scope of standard, and the manner to apply the standard.

3 Research framework and methodology

In order to investigate the possible IFRS for SMEs implementation we use an extended institutional framework. Institutional theory has been extensively used in studies analyzing IFRSs implementation and/or accounting change (Dillard et al., 2004; Rodrigues and Craig, 2007; Irvine, 2008) because it emphasizes the importance of institutions, beliefs, rules, routines, and culture. Institutionalization is the process whereby practices are developed and learned (Dillard et al. 2004, p. 508). The institutionalization of accounting is made by isomorphism, meaning the process by which an organization adopts an institutional practice. DiMaggio and Powell (1983) (as used by Dillard et al., 2004; Mir and Rahaman, 2005) identify three mechanisms through which institutional change occurs: coercive, mimetic and normative. Coercive isomorphism results from external pressure and certain practices are adopted as a result of governments' or capital markets' pressures or the expectations of the larger society. Mimetic isomorphism is seen as adopting best practices in order to be more legitimate or successful. Normative isomorphism is given by the professionalization, in that the members of a profession define methods of work. Also, sometimes a gap occurs between the formal and informal practices, between the image presented and the reality, gap called decoupling (Rodrigues and Craig, 2007; Irvine, 2008).

Rodrigues and Craig (2007) advanced a framework for the assessment of international accounting harmonization, in which they use, besides the logics of the institutional theory, Hegelian dialectic. Accordingly, the authors provide three metaphors: *thesis* – an element with contradiction to its structure (for example, support for the globalization of accounting); *antithesis* – an opposite directly created for the thesis (for example, opposition to accounting globalization); and *synthesis* – a third point of view developed as a consequence of the opposition between thesis and antithesis. Rodrigues and Craig (2007) argue that the process of convergence of accounting standards is a dialectical process of thesis, antithesis and synthesis. We will employ the framework based on the concepts of institutionalization, isomorphism, decoupling, thesis, antithesis and synthesis in order to provide insightful explanations on the positions of different actors about the IFRS for SMEs in emerging countries, and on how accounting for these entities might progress in the future.

working group recommendation received during the due process (IASB 2008, p. 10). The comment letters received indicated that SMEs imply a size test and are often defined in quantified terms by local or regional laws and regulations, while the field tests revealed some confusions in this respect as the ED definition for SMEs was inconsistent with those in particular jurisdictions. The term “non-publicly accountable entity” was also considered, but finally the Board considered that SMEs is the better term to use (BC 79). Finally, the standard defines them SMEs as “entities that do not have public accountability, and publish general purpose financial statements for external users” (par. 1.2).

Single-country case studies are useful to understand the local context and its possible reaction to a change of the accounting regulatory model. We will focus on the context of Romania, a country sharing some commonalities with other emerging economies such as the orientation towards IFRS in order to develop the economy and attract investors, and the underdeveloped accounting profession.

Firstly, in terms of the logical suitability of the implementation, secondary data will be used to perform an analysis of two types of regulations and standards possibly affecting SMEs: the IFRS for SMEs as issued by the IASB, and Romanian accounting regulations, respectively. Previous literature documents a high degree of fiscal influence on accounting treatments in emerging countries. Because accounting profit is the starting point for the determination of the taxable profit and distributable profit, a concern of regulators and companies is what impact might have the application of the IFRS for SMEs on the taxable and distributable profit. More than that, we acknowledge the importance of the *de jure* and *de facto* differences previously identified in the harmonization process. In this context, we will conduct a detailed content analysis of the two sets of requirements in order to ascertain the logical suitability of IFRS for SMEs application in our country, and the sources for possible decoupling.

Secondly, primary data was gathered to obtain insights on the perception of various groups of actors involved in financial reporting for SMEs (such as users, owners, accountants, regulators, academics and auditors), through means in-depth semi-structured interviews. Details regarding the interviews and the interviewees, their background and previous experience are presented in Appendix A. Interviews were conducted in order to obtain an initial understanding of the issues related to this possible implementation of the IFRS for SMEs. This is an exploratory analysis of the context of SMEs in respect with their size, the users of accounting information and their expectations, the competencies of accountants, their exposure to the international environment, available resources, or the degree of fiscal adherence in accounting documents.

Finally, and deriving from the two previous stages, three possible scenarios are developed and analyzed. They are built upon four dimensions viewed as significant to frame the possible implementation of the IFRS for SMEs in emerging economies. These dimensions are developed and their consequences are discussed.

Regarding the field work, this paper is based on a perceptual instrument (the interview). This is due mainly to the ‘future’ nature of the discussion: the IFRS for SMEs has not been applied as of yet in Romania and the professionals having already worked with it are probably inexistent. While the perceptual nature of such an instrument may be subject to limitations, the ‘questionable’ nature of perceptual instruments has been challenged very recently in literature, as literature demonstrates that using a perceptual instrument does not impair the analysis (Henri and Journeault, 2010).

The interviews were conducted in Romanian, so as to ensure a better understanding of the subjects under discussion. Permission to record was asked at the beginning of each interview. Some interviews were accordingly recorded. When such permission was not granted, notes were taken during the interviews, with immediate full transcription after the interview, in Romanian. Special care was shown in selecting the interviewees, as various groups are relevant to the possible IFRS for SMEs implementation (such as fund providers – especially banks, accounting and consultancy firms, the State, professional bodies etc.). Their interests are of course not the same, and an exploration of these (most probably) divergent

perspectives will benefit the contributions of this study. This method allows researchers obtain more insightful opinions than large surveys, and we thought that it would bring more significant results given the complexity of the issue. The relatively small number of interviews might be considered as a drawback for the generalization of the study's results. However, the number of persons interviewed largely exceeds the number of respondents for the EU's consultation². Also, we provide input from different categories of actors, and use interviews to obtain a more in-depth understanding of the particularities of each group.

4 The case of Romania

4.1 Analysis of national accounting setting

A previous comparison was made between the European Directives and IFRS for SMEs (EFRAG 2010), and a reduced level of incompatibility was found. However, there are differences in how the European Directives are applied in different countries (Haller, 2002; Day and Taylor, 2005).

After the fall of communism in 1989, Romania has been influenced by the French accounting thought, followed by an IAS influence (Ionașcu et al., 2007; Albu et al., 2011a). Starting 2007, Romania is a member of the European Union and the European Directives are enacted in the national regulations. However, the national systems still have some influences from the models used over time for the accounting reform and also have an orientation towards IFRS.

The Romanian regulatory system was public from the beginning, with a pretty elusive due process and a reduced influence from other third parties such as professional bodies, users and/or academics. An interest for IAS was shown during the second step of the accounting reform due to the intervention of the World Bank (King et al., 2001), but the regulator has not disclosed the results of impact studies, if any, related to such a radical change.

As already explained, historically the financial reporting model of emerging economies has suffered different influences, which sometimes resulted in the occurrence of some inconsistencies in the national legislations, especially in terms of the measurement bases and recognition policies; this may hinder the possible implementation of the IFRS for SMEs in these countries. This is also the case in Romania.

The national regulations are in line with the European Directives (since Romania is a member of the EU), but do have some influences from IFRSs. As a common trait of previous accounting models, there are still some areas not fully clarified/addressed:

- the objective and the users of financial statements – only recently (2009), the Romanian regulator acknowledged the users of financial reporting in the national regulations; however, the objective of financial statements is not clarified;
- the definitions of assets, liabilities, equity, expenses or revenues – Romanian regulations include the definitions from the IASB's conceptual framework (but with inconsistencies in the application);
- accounting principles – while materiality and substance over form exist in regulations, there was a reduced importance of their application in the case of SMEs.

² For the EU's consultation there were 2 respondents from Romania (EC 2010, p. 4). The respondents were representatives of regulators and professional bodies.

Besides these general considerations, differences between the national regulations and the IFRS for SMEs exist and will influence the possible implementation. Measuring and analyzing these difference is a difficult process. A general analysis was realized by the largest Romanian professional body (the Body of Expert and Licensed Accountants of Romania, ro. Corpul Experților Contabili și Contabililor Autorizați din România) (CECCAR 2010), comparatively analyzing similar paragraphs from the IFRS for SMEs and national regulations. Their results provide a general overview of the differences and similarities between the IFRS for SMEs and the Romanian regulations. However, they do not provide a methodology for measuring the differences or similarities.

Also, while general studies are useful, analyses focused on specific topics are necessary to understand the mechanisms of convergence. For example, for inventories, an item with a significant impact on the financial statements of many entities, previous studies in Romania report that the treatment is generally in line with that of the IFRS for SMEs (except for LIFO which is allowed in Romanian regulations). However, based on an in-depth analysis, Albu et al. (2011c) find a convergence index for inventories of 0.51, and a divergence index of 0.35. Also, the authors find that some of the provisions of the national regulations do not influence the convergence or divergence with the IFRS for SMEs (what they call the guidance index, whose value is 0.14). This analysis provides insight regarding the magnitude of differences for specific items (which is difficult to assess in general studies) and documents the need for detailed (rule-based) regulations in emerging economies.

A sensitive issue is the close relationship between accounting and taxation, and the use of fiscal rules in accounting. In Romania the State is considered the main user of the accounting information and the financial statements are based on tax regulations (Albu et al., 2009). The financial statements prepared in accordance with IFRSs are considered more useful for users, but they lead to a higher cost for companies because these are a second set of financial statements.

The differences between the national regulations and the IFRS for SMEs are important to be evaluated before the implementation of the latter. These differences provide a general overview of the changes in accounting practices, of the needs in terms of training, and about the way in which national practices may influence the application of the IFRS for SMEs (in line with the notion of path dependency). Our comparative analysis identified areas in which the application of the IFRS for SMEs would bring simplifications (such as the non-capitalization of some intangibles, or the use of the cost model for property, plant and equipment). Also, our analysis leads to the identification of the requirements of the IFRS for SMEs which would need further attention: the use of fair value (for instance, for investment properties or financial instruments) and the use of professional judgment (regarding the lease contracts, the impairment tests, or deferred taxes) and the need to develop managerial accounting competencies that would support a thorough application of the IFRS for SMEs (such as cost calculations, or supporting calculations for conducting an impairment test). Also, there is a concern that the IFRS for SMEs is not as detailed as the national regulations, which may lead accountants to use previous regulations or fiscal regulations.

4.2 Implications of a possible implementation of the IFRS for SMEs

Our interviewees generally define SMEs by reference to the legal definition based on quantitative thresholds. These criteria are the number of employees and turnover, or total assets. Even if the interviewees consider that these quantitative criteria are useful, they raised several possible issues. R5 (preparer) noticed that turnover is a relevant measure. From his point of view, there are entities that have a small number of employees and low amounts of assets but that generate a high turnover by working with intellectual capital. In his opinion, these entities should not be considered SMEs.

The conclusions issued from the interviews confirm that SMEs do not form a homogeneous group. Also, our interviewees are of the view that different types of SMEs raise different issues for preparers, and that users employ additional classifications for their specific needs. Some of the insights from the interviews are in line with what previous literature on SMEs already reported: the reduced number of owners, the reduced complexity of the activity, and the reduced size are the general characteristics of SMEs. However, some aspects outlined in other studies (Kirsch and Meth, 2007 cited by Di Pietra et al., 2008; Campenhout and Van Caneghem, 2009) are not mentioned by the interviewees: the level of risk and the profitability of SMEs, and the level of international exposure. Also, if in other studies (Paoloni, 2006 cited in Di Pietra et al., 2008; Eierle and Haller, 2009) size is considered as a critical characteristic with implications for accounting and users, it seems from our interviews that other criteria such as turnover, the number of owners, the type (and complexity) of finance sources are also important criteria.

Two issues of major importance for SMEs accounting are the relationship with taxation, and the users of the accounting information published. The interviewees generally consider that in Romania a traditional link between accounting and taxation exists, and that the tax authority is the main user of accounting information. Generally, besides the tax authority, other users of accounting information are the banks, business partners, and owners. SMEs are financed by banks and consequently bankers have to be considered an important category of users. Users consider that often SMEs financial statements are completely useless for credit rating purposes. Consequently, banks use other types of information. R2 (user) said: “We now are even encouraging bankers to go see the company, if they have inventories, if they have production. If the production process is well organized, it means that the manager is good”.

If the links to taxation and the importance of the tax authority as user of financial reporting information are in line with previous literature, the major point issued from our interviews is linked to the reduced degree of education of the accounting profession and of the business environment. The interviews offered insights from the perspective of emerging economies, in which the accounting profession had to undergo the changes of several accounting reforms and in which the managers’ and users’ awareness of accounting issues is limited. For example, R6 (professional body) said: “The privileged user is the fiscal authority [...] Other users are the banks, the management... here things should be nuanced because in a lot of cases administrators do not understand the merits of a reporting system, do not exploit accounting information and do not require the skills of the accountant to produce information that could be useful for them.”

Also, in these countries the other users except from the fiscal controllers do not make pressures for more qualitative accounting information. R5 (preparer) said that the economic environment should ask for accounting information, but “today nobody is interested about how financial statements are prepared”.

The general opinion about the accounting profession in these countries is that it is underdeveloped and has difficulties even to apply the national rule (not principle) based regulations. R2 (user) said: “Accountants developed their competencies in the law’s interpretation and fiscal code’s application. This is their competitive advantage. I saw some of them trying to conduct financial analysis. It was so hard for them, because they were not seeing behind the debit – credit rules...”

The most important implementation costs perceived by our interviewees are related to the training of accountants, and to the possible multiplication of reporting systems. Other costs would be related to the upgrade of IT systems. Additionally, the cost of external experts and auditors would increase the cost of IFRS for SMEs implementation.

The main benefit as perceived by our interviewees would be related to the increased comparability and quality of financial reporting. Other benefits mentioned are the increased financing opportunities, the decreased cost of capital and the opportunities for the internationalization of SMEs. Also, another perceived benefit would be the separation between accounting and taxation. On the other hand, the introduction of the IFRS for SMEs could be a way to bring financial accounting and managerial accounting into convergence. This might be beneficial from the point of view of the stewardship objective of accounting.

These benefits are generally associated with the IFRSs application worldwide, but insights from our interviews suggest another benefit (or effect) which seems to be particular to emerging economies: the change in the accounting culture, in the mentality of accountants and of the business environment. R6 (professional body) noticed that for the profession, the application of this standard will lead to a change in the role of accountants in organizations.

But this general perception of improvements in reporting and of the accounting profession should be also supported by the development of the economic environment. R5 (preparer) underlined that “On the short term the costs will exceed the benefits. It [N.A. the implementation of the IFRS for SMEs] is worth on the long term. But if the environment doesn’t change it will not work. I see the utility because I am also an academic, but I see what it happens in practice too. Accounting is influenced by these other issues... If the auction is not fair what is the use of financial information?”

Another expected effect in these countries would be the enhancement of investment opportunities, the development of a more reliable environment for investors and increased opportunities for doing business with foreign entities. R2 (users) said: “Everybody would benefit from its [N.A. IFRS for SMEs] application. The business environment could benefit... if you are an employee, supplier, client, or a public institution intending to work with a SME...”

4.3 Scenarios for the IFRS for SMEs implementation

By incorporating insights from the interviews, the preliminary analysis of logical suitability, the opinions of the respondents to the EU's consultation, and with an in-depth understanding of the local environment we propose and discuss in this section several scenarios for the IFRS for SMEs implementation. We will mobilize the extended institutional framework as discussed by Rodrigues and Craig (2007).

At a basic level, we would thus depict the main influences on the financial reporting regulations in Romania, with similarities with many other emerging economies:

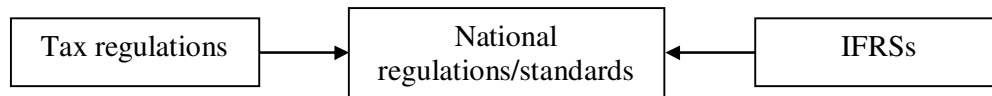


Figure 1. Main influences on the financial reporting regulations/standards

As we have already explained, there is a close relationship between financial reporting (financial statements in accordance with the national regulations) and taxation. This relationship is characterized by: many fiscal rules being used for financial reporting purposes; the accounting profit is the starting point for the calculation of the taxable profit; the objective of many SMEs is the optimization of the taxable profit. A straight connection could create incentives for preparers that may hamper the quality of financial reporting. On the other hand, IFRSs have also influenced to various extents the national regulations, for global convergence purposes or due to the need to gain legitimacy in order to attract foreign investors. This dual relationship leads however to a difference between the *de jure* and the *de facto* convergence between the national regulations/standards and IFRSs. In this sense, R5 (professional body) notices that even though a good level of convergence of national regulations with IFRSs is achieved in Romania, there is a weaker *de facto* convergence because practices are influenced to a high extent by the fiscal rules.

For the time being, entities have to fulfill both accounting and fiscal requirements. Probably the cost of having two sets of requirements is an important force bringing them closer. In this context, the implementation of the IFRS for SMEs raises some questions, *inter alia*: (i) Should the IFRS for SMEs be used as a third referential? (ii) Should the standard replace the national regulations? (iii) Would, in this latter case, the tax authorities accept the accounting profit as a starting point in determining the taxable profit?

There are three possible approaches to the relationship between tax and accounting when changing the accounting system. The first solution is to calculate taxable profit based on the accounting profit determined in compliance with national regulations. In this case fiscal authorities will have full control over the tax policy; they will not have to change fiscal rules so the incompatibilities between IFRS for SMEs principles and fiscal rules will not need to be addressed. This is not sustainable on long term because of the costs involved with double reporting and work to determine deferred tax. At the opposite side is the adoption of IFRS for SMEs for fiscal purposes. This would save reporting costs and facilitate fiscal harmonization within EU. Fiscal authorities will not have to reconcile the two sets of rules to determine fiscal profit. But due to incompatibilities between IFRS and tax principles this solution will not be feasible either. Between the two solutions is the so called „quasi dependent” approach which involves the reconciliation of the profit determined under IFRS for SMEs with taxable

profit. This will implicate an effort from tax authorities and will increase the complexity of the fiscal rules. Although from a conceptual point of view the last solution seems to be preferable, technical issues that could arise should not be underestimated. The fiscal authority should adjust tax rules every time when IFRS for SMEs is revised, should solve the problems related to the fiscal status of gains and losses during the transition phase and ensure the equal treatment of tax payers applying different accounting rules. This solution has the advantage of facilitating to a certain extent the fiscal harmonization within EU. The application of full IFRS at the individual financial statements level will determine regulators to handle all these issues.

We will illustrate these relationships with arguments from the interviews and from the EU’s consultation (EC 2010) in order to understand the position and interests of different actors involved in the accounting process.

The representatives of the Ministry of Public Finances (accounting regulators or important actors in this process) generally support the tight relationship between the national accounting regulations and the taxation rules, thus not being too much in favor of the IFRS for SMEs application. Consequently, the relationship with taxation would be preserved. On the other hand, the users of the accounting information (for example, bankers) tend to support the application of the IFRS for SMEs, considering that IFRSs bring more flexibility and more relevance to financial statements (R2, user). For preparers, the most important issues are the cost of fulfilling the reporting obligations and their complexity. This may lead to reluctance in applying accounting policies different than the fiscal ones (R5, preparer). However, some entities are aware of the benefits of separating the accounting system from taxation (R4, preparer; R5, preparer). Eventually, for entities it is a matter of costs and the pressure they perceive as being more important – that of the fiscal controllers or that of their users.

We would thus synthesize the complex relationship between financial reporting, taxation and IFRSs in Romania as an emerging country, incorporating also the general characteristics of the environment of emerging countries:

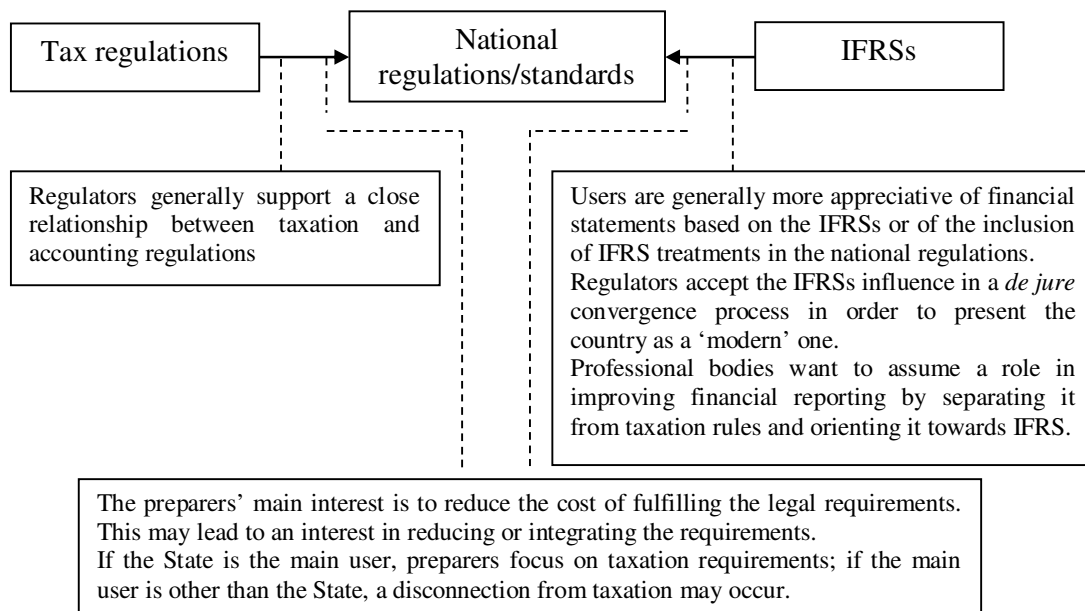


Figure 2. Stakeholders’ positions vis-à-vis the relationship between financial reporting, taxation and IFRSs

Based on this analysis, we argue that the position towards the IFRS for SMEs should (and probably will) be based on the concept of *synthesis* in the sense of Rodrigues and Craig (2007), even if there are voices that radically argue for (*thesis*) or against (*antithesis*) this standard's implementation. Arguments might be found to support the idea that IFRS implementation is necessary for SMEs too for the support of global economic development, and for providing useful and comparable information (*thesis*). Based on this argument, IFRS for SMEs should be adopted and implemented. But on the other hand, accounting develops in close relationship with the local environment, and different countries and types of entities might need different accounting standards (*antithesis*). This antithesis supports the idea that IFRS for SMEs should not be adopted.

The position of different states at the EU's consultation (EC 2010) and even UK's plan of adopting the standard only for some SMEs (Nobes 2010, p. 217) and the decision to modernize the European Directive serve as arguments that IFRS for SMEs will not (at least in the near future) be implemented for all the SMEs in the EU. Given the importance of political factors in the process of global accounting convergence (World Bank, large accounting firms, other parties) which award "power" to the IFRSs (as already described by Rodrigues and Craig, 2007), we think that the scenario of completely ignoring or rejecting the IFRS for SMEs is highly improbable too. We argue that the *synthesis*-type scenarios (of not ignoring/rejecting the IFRS for SMEs) have to take into consideration the following dimensions:

- the scope – a full (all SMEs) or partial (only some SMEs) application. The application to all SMEs will ensure comparability and will avoid the issue of finding criteria to identify another category to be included in the scope of the standard. On the other hand, SMEs do not form a homogeneous group and probably the application of the standard is not desirable (by the national regulators) or appropriate (considering the cost-benefit ratio) for all SMEs.
- the degree of coerciveness – the standard may be mandatory or optional. The EC already held a consultation on the position of different actors regarding the coercive character of the standard. This dimension could be viewed in terms of EU's or national level.
- the tax-base character – the advantage of recognizing the standard as a tax base would imply a reduction in the cost of fulfilling different requirements by SMEs. Prior research discusses the opportunity and the implications of accepting IFRSs as a tax base (Freedman, 2004; Eberhartinger and Klostermann, 2007).
- the adoption of the standard or its adaption to the local context. The adoption of the standard would imply its application in the form issued by IASB, without any amendments³ (Zeff and Nobes, 2010). Besides this strict sense of adoption, there are different ways of adaption, or convergence, which imply more or less changes to the standard in its form issued by the IASB.

The different combinations of these dimensions lead to a significant number of scenarios, some of them standing more chances to materialize than others. Also, some of these scenarios (more or less close to those developed below) are envisaged by some countries around the world⁴. These scenarios might be commented by the metaphor of *synthesis*.

³ This would imply finding a method to insert into the local law quickly and without change any output of the IASB on this standard (Zeff and Nobes 2010, p. 180).

⁴ See the news presented on www.iasplus.com for the intentions or plans of different countries.

The first scenario – adoption of the IFRS for SMEs by some SMEs

This scenario would imply the adoption (in the strict sense previously referred to) of the IFRS for SMEs only for some entities, while for the others national regulations (accounting or fiscal) would continue to apply. A multi-tier system is a form a *synthesis* (Rodrigues and Craig, 2007). This scenario might be supported by the need of some entities to have a better reporting framework.

One of the possible categories for which the application of the IFRS for SMEs might be mandatory and easy to implement would be consolidating SMEs, for their consolidated financial statements. Some interviewees expressed views that are coherent with this scenario. However, this would limit the application of the standard to a small number of entities, and others interviewees considered that other entities would need to be included in the scope of the standard too. In the same line, the existent literature shows that SMEs are not a homogeneous group from this point of view, and that only some SMEs will benefit from the standard's application (Kirsch and Meth, 2007 cited by Di Pietra et al., 2008; Schiebel, 2008; Sellhorn and Gornik-Tomaszewski, 2006).

Determining the scope of the IFRS for SMEs application involves the use of quantitative or qualitative criteria. Most of our interviewees agree that qualitative criteria (similar to the IASB's view of the SME) are more appropriate, but probably a quantitative approach is more common in the EU. Establishing the scope will be a difficult task, because while more qualitative criteria might be more appropriate, they would be more difficult to be applied in practice. R6 (professional body) argued that "I fear that qualitative criteria could be difficult to enforce with entities acting in an unpredictable environment and having such atypical behavior".

Another issue to be considered is the relationship with taxation. The interviewees wish that the adoption of the IFRS for SMEs will lead to changes, simplifications and clarifications of the taxation system. Nobes (2010) also explains that because the application of IFRSs will impact the profit, the regulators will not accept IFRSs in a country in which taxable income is related to the accounting profit because they would lose control over the taxable income. This view is also supported by our interviews. Preparers and professional bodies, expectedly argue for the consideration of the standard as tax base (Fig. 2).

The second scenario - IFRS for SMEs as an option

One of the most probable situations (at least from the political standpoint) is to permit the application of the IFRS for SMEs. Preparers and users generally tend to agree with this scenario. R5 (preparer) argues that "In my view, the entities should be left to appreciate what kind of financial reporting they need, but in practice it is difficult to do this because of the mentality." Also, R2 (user) is of the opinion that the 'option' scenario is better because it would not generate immediate high costs for entities.

However, the potential actual use of the standard under this scenario is questionable because prior research shown a reduced degree of voluntary adoptions of accounting standards by the European SMEs (Nobes, 2010) and usually it is the result of users' pressures. This would have implications on the quality of "adoption", the costs and the supposed power of users. The late is not always true in emerging economies. The users (banks) also mentioned during

our interviews that they cannot make huge pressures for an increased quality of accounting reporting because someone else on the market would extend credit without paying too much attention to the financial statements.

On the other hand, the voluntary adoption raises the question of the scope and the meaning of adoption (Nobes, 2010). Compliance with IFRSs should be claimed only when all the provisions of the standards are applied. This will turn the pressure on auditors, awarding them an important enforcing role, but not all the financial statements have to be audited in accordance with the current regulations.

This scenario might be implemented in different manners: the standard is accepted as a tax base (and national regulations are not required anymore) or dual reporting (entities have also to comply with the national regulations, for tax purposes). However, it is difficult to imagine that different tax bases would be allowed in the same country in the case of a voluntary adoption. More than that, there is some reticence towards recognizing the IFRS for SMEs as a tax base.

In this case, one solution might be dual reporting. But this would be costly and only a few entities would probably use it. In order to support this idea, R4 (preparer) offered the experience of the group he works for, advancing the hypothesis of delisting an entity because it is too costly to maintain double reporting (in accordance with IFRS and in accordance with the national regulations).

The third scenario – convergence towards the IFRS for SMEs

Convergence plans in order to eliminate the dual system (national/international standards) is advocated by some (Larson and Street, 2004, p. 113) as a solution for the problems faced by regulators in the context of the international harmonization.

The Romanian regulator explained the advantages of a convergence plan between the European Directives and the IFRS for SMEs in its answer to the EC's consultation. The convergence might also allow for an adaptation of the standard to the local conditions, although on the short run would impair full comparability (we will refer to this issue later). Some of the interviewees mentioned the difficulties of applying the IFRS for SMEs and the advantages of some more additional details. One of the major issues is the fair value, usually less employed in these countries.

R5 (preparer) also believes that the standard should be adapted to the national particularities, arguing that many practitioners would consider it incomprehensible as is. R6 (professional body) and R7 (academic, regulator) agreed that a convergence strategy would work best in the Romanian context, in which the national standard (based on the IFRS for SMEs) would also include a chart of accounts, details about the accounting documents and inventory taking details. Consequently, this scenario would actually suppose a partial convergence (as defined by Zeff and Nobes, 2010), because some of the IFRS for SMEs treatments would be modified and additional rules would be added, but it would have the advantage of permitting national standard setters to ensure full compliance with the European Directives also.

Now we will discuss these scenarios using the institutional theory. In our opinion, the first scenario would be a form of coercive isomorphism. The differences between the environment of emerging countries and the one for which the IFRS for SMEs has been issued will likely generate differences in the application of the standard. Consequently, we argue that the sole existence of coercive factors might lead to resistance and decoupling. This situation already happened in Romania when the application of IASs was mandatory for all large entities (irrespective of the existence of users), and a large level of decoupling manifested (Albu et al., 2011a). However, this scenario could lead to a higher level of *de jure* comparability across the EU, but the position of the national regulators and especially of the tax regulators is very important in order to minimize the administrative burden of SMEs.

The second scenario would mainly represent a mimetic form of isomorphism; the option of using the IFRS for SMEs would be used by the entities that want to show a level of reputation, modernity, transparency and adherence to good practices. However, without coercive and/or normative isomorphism, this scenario might stand low chances of generating the application of the standard. Some of the preparers said: “if the accountants are not forced to do something, they will not do it” (R5, preparer). This scenario might be easier to be accepted by the national regulators and could be considered a first step towards a mandatory adoption (the first scenario). However, a higher administrative burden could be foreseen for entities, as well as a low level of voluntary adoption.

It is already advocated that the convergence of many countries’ accounting model towards IFRSs is an example of normative isomorphism (Rodrigues and Craig, 2007, p. 753). Consistently, the third scenario would be a form of normative isomorphism. This also involves a significant role of the education. Also, the position of professional bodies in supporting the separation of accounting from taxation and the orientation towards IFRSs is another form of normative isomorphism. However, if Big 4 played a significant role in the normative isomorphism regarding the application of full IFRSs, their implication is less obvious in the context of SMEs.

Some (Chand, 2005; Rodrigues and Craig, 2007) argue that before adopting IFRSs, an improvement in the level of education should be achieved, i.e. normative isomorphism. Some of the interviewees insisted on the reduced competencies of the accounting profession and expressed concerns about how the profession would manage to apply in full the IFRS for SMEs.

We are aware that the process of change is slow, and previous practices influence the way in which the new standards are applied. The proper application of the standard would imply a change in mentality, both from a rule-based to a principle-based application, and from a fiscal to an accounting (transparency and/or decision making) orientation. Consequently, a cultural revolution is needed in order to obtain a radical change (Mir and Rahaman, 2005, p. 830). The educational process will be slow and difficult. R5 (preparer) said: “They [N.A. accountants] said that they learn quickly, but in practice they are used with routines, they apply solutions in a mechanic manner. [...] Developing professional judgment is also important”.

Considering all these arguments we argue that the scenario chosen by regulators should focus on this long-term strategy (convergence to the IFRS for SMEs), as we consider that the most important form of isomorphism is the normative one. “Education is necessary if we want things to evolve. A culture for education of the accounting profession should be developed” (R7, academic, regulator). The convergence with the IFRS for SMEs might be considered as an opportunity for developing the business environment and the accounting profession in these countries. This is in line with the advocated need to devote resources to the development of the education and profession in developing countries in order to improve the accounting system (Chand, 2005).

Another important point is the relation with taxation. Some (Freedman, 2004) argue that the EU should simplify and harmonize the tax system and the discussion around the adoption of/convergence with the IFRS for SMEs might be a good moment. In order to be perceived as cost-benefit acceptable, the decision regarding the adoption/adaption of the standard should be accompanied by simplifications in the tax regime and a rethinking of the relation between accounting and taxation.

5 Conclusions

SMEs play an important role in the global economy and their accounting issues are recently under debate, especially after the issuance of the IFRS for SMEs by the IASB in 2009. This paper exemplifies using the example of Romania the case of emerging economies and their stakeholders’ positions vis-à-vis this standard. It is already known that these countries are more oriented towards international standards for legitimating purposes, but they have an underdeveloped accounting profession. The purpose of this paper was to discuss the possible scenarios and implications of the IFRS for SMEs implementation in emerging economies.

Our study provided evidence that there are conceptual problems in the current regulations of emerging economies, that these regulations are influenced by taxation and have a rule-oriented approach. The magnitude of the differences between the national regulations and the IFRS for SMEs would increase the cost of a possible adoption of the standard. The interviews with the representatives of the main actors involved in the accounting process (preparers, auditors, professional bodies, regulators, academics, users) revealed their perception about the characteristics of SMEs and SMEs accounting, the costs and benefits of a possible implementation of the standard, and their position vis-à-vis the implementation strategy. The SMEs are not considered as a homogeneous group and while the majority of interviewees agree on the use of quantitative criteria to classify the SMEs, many of them employ other criteria than those officially used. This result might be important in the context in which the regulators might take a decision in relation with the existent criteria.

Besides the strong links to taxation, the interviews revealed that accounting profession and accounting is underdeveloped in these countries and users do not trust and use to a high extent the information produced by accounting. Also, the users do not make high pressures to obtain more qualitative accounting information. Under these circumstances, the change in the accounting system (i.e., the possible adoption of the IFRS for SMEs) is considered as a mean to educate and change the accounting profession and the business environment.

Because different actors have different positions, based on their interest in the accounting process, we employed an extended institutional framework (based on Rodrigues and Craig, 2007) in order to discuss the possible strategies. We argue that a complete adoption of the standard (for all SMEs and as issued by IASB) as well as a complete rejection are not probable, thus we proposed and discussed three scenarios based on the concept of *synthesis* (Rodrigues and Craig, 2007). The first scenario would imply the adoption of the standard for some SMEs and would be mainly based on a coercive-type of isomorphism. A significant issue will be the selection of the SMEs to apply the standard. The second scenario is based on the voluntary adoption (the standard being considered an option), that would mainly be a mimetic-type of isomorphism and would raise questions about costs, enforcement, comparability and quality of adoption. The third scenario is based on the idea of convergence of the national regulations and standards with the IFRS for SMEs, with the input of the accounting profession and professional bodies (normative isomorphism).

Considering the characteristics of accounting in these countries and considering the educational needs, we argue that the most preferable approach should be the normative isomorphism, i.e. the continuous education of the accounting profession and of the business environment (the third scenario). Therefore, we argue that in the first two scenarios the decoupling will outweigh the benefits expected from the application of the standard. However, attention should be paid to the differences that will exist between the national regulations/standards and the IFRS for SMEs in order to eliminate them over time. In this context, the education should be focused on a principle-based teaching of the IFRS for SMEs in order to prepare the profession for the professional judgment necessary to apply the standard.

The results should be analyzed in the context of a reduced body of research in emerging countries and on IFRS for SMEs implementation. Future research is needed in order to further investigate the role of institutional characteristics of different countries, and to identify the most appropriate convergence mechanisms. Also, empirical research might provide evidence about the costs/benefits and effects of the changes in the accounting regulations. The political issues, such as the position of the national regulators, the relationship with taxation, the lobbying issues, the strategies of professional bodies, also deserve proper academic attention.

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Appendix A

| Interviewee | Acronym | Position, experience | Date and Duration |
|---------------------|---------|---|-----------------------|
| Auditor | R1 | - director – consultancy department – Big 4 - 9 years of experience, of which 5 in auditing - a lot of experience in working with full IFRSs | 15.03.2011 65 min. |
| User | R2 | - user, business analyst and consultant - prior experience in audit (including IFRS) | 90 min. |
| Auditor | R3 | - audit manager - 6 years of experience - 3 years of experience in working with full IFRSs | 40 min. |
| Preparer | R4 | - CFO - 11 years of experience - prepares financial statements in compliance with full IFRSs | 14.03.2011 55 min. |
| Preparer | R5 | - Chief accountant and academic - 11 years of experience, of which 5 years of experience in working with SMEs on national regulations - exposure to IFRSs by teaching them in higher education | 10.02.2011 60 min. |
| Professional body | R6 | - Representative of the National Institute of Continuous Professional Development of the Body of Expert and Licensed Accountants of Romania (CECCAR) and academic - experience in teaching full IFRS and IFRS for SMEs to different audiences | 11.02.2011 65 min. |
| Academic, regulator | R7 | - member of the Council of Accounting and Financial Reporting (frequent interactions with the Ministry of Finance) and academic - observer of the accounting regulation process in Romania across all the steps of the accounting reform - teaches IFRSs to different types of audience | 17.03.2011 60 min. |