



Faculty of Commerce

Accounting and Auditing Department

Accounting Problems Facing The Preparation of Financial Reports For The Egyptian Small And Medium Size Entities With Respect To The International Accounting Standards

(A Field Study)

**المشكلات المحاسبية عند إعداد التقارير المالية في المنشآت الصغيرة و متوسطة الحجم في
مصر في ضوء معايير المحاسبة الدولية – (دراسة ميدانية)**

A thesis submitted for the fulfillment of master degree in accounting

Prepared by :

Niveen Mohamed Ezz El- Din Mohamed Mohamed Fayed

Supervised by :

Dr . Mohamed Ali Lotfi

Associate Professor of accounting and auditing

Faculty of Commerce

Ain Shams University

Dr . Mohamed Abd El Kader

Lecturer of accounting and auditing

Faculty of Commerce

Ain Shams University

Acknowledgement

- I would like to express my great appreciation to ***Dr. Mohamed Ali Lotfi*** for his valuable instructions and support during the development of this thesis .
- I would also like to thank the examination committee :
Professor Dr . Mohamed Abdelfattah Mohamed and ***Dr. Shehata El Sayed Shehata*** for their care and attendance to discuss my thesis .
- My grateful thanks are also extended to ***Dr. Medhat Mohamed Abdelaal*** for his support in conducting the statistical analysis .
- Finally I want to thank my family and all my friends for their support and encouragement throughout my study .

Research Outline

Chapter One : Research Framework :

- Introduction . 7
- Research problem . 9
- Research objectives . 10
- Literature review . 11
- Research hypotheses . 28
- Research limitations . 28
- Research importance . 29
- Research plan . 29
- References of chapter one . 30

Chapter Two : The Effect of Accounting Problems on Financial Reporting in Small and Medium Size Entities (SMEs):

- Importance of SMEs . 35
- Definitions and characteristics of SMEs . 36
- Financial reporting in SMEs . 41
- Problems facing SMEs . 43
- Trials to overcome the problems . 47
- References of chapter two . 51

Chapter Three : An Analytical and Comparative Study between The International Financial Reporting Standard of Small and Medium –size Entities and The Egyptian Accounting Standards :

• Introduction .	57
• Modifications to the Full IFRS .	59
• Comparative analysis between IFRS for SMEs and the Egyptian Accounting Standards :	
a) Interim financial reporting .	62
b) Segment reporting .	62
c) Borrowing costs .	62
d) Government grants .	62
e) Investment property .	63
f) Property , plant and equipment .	63
g) Intangible assets .	64
h) Goodwill .	64
i) Impairment of assets .	65
j) Special accounting for assets held for sale .	65
k) Insurance contracts .	65
l) Research and development costs .	66
m) Extractive industries .	66
n) Investments in associates .	67
o) Investments in joint ventures .	67
• References of chapter three .	68

Chapter four : The Field Study :

- Introduction . 72
- Statistical analysis . 77
- Conclusions . 158
- Recommendations . 159

Bibliography :

- English references . 162
- Arabic references . 169
- Theses . 170
- Publications and conferences . 171
- Internet sites . 172

Appendices :

- Appendix (A) : List of abbreviations . 176
- Appendix (B) : Translated Expressions . 178
- Appendix (C) : Statistical tables . 182
- Appendix (D) : English Summary . 234
- Appendix (E) : Arabic Summary . 242
- Appendix (F) : Questionnaire . 250

Chapter One : Research Framework

Chapter One : Research Framework

Index:

1/1 : Introduction.

1/2 : Research problem .

1/3 : Research objectives.

1/4 : Literature review.

1/5 : Research hypotheses.

1/6 : Research limitations.

1/7 : Research importance.

1/8 : Research plan .

1/9 : References of chapter one .

1/1 : introduction:

With the beginning of the twenty first century, there have been many changes in the economic and commercial activities across the globe, taking for example: the widespread of electronic commerce (E-commerce) transactions in addition to the emergence of multinational companies with branches all over the world , therefore all these factors have resulted in increasing the extent and number of foreign operations and accounting transactions among different countries .

In the past each country applied its own national accounting standards that were relevant to its accounting and financial reporting needs, but the economic changes and the increased volume of accounting transactions among different countries addressed the need for adopting uniformed accounting standards to be applied globally.

There are two main sets of accounting standards:

- **The first group:** The American *Generally Accepted Accounting Principles (GAAP)* which was issued by *The Financial Accounting Standards Board (FASB)*.
- **The second group:** *The International Accounting Standards (IAS)* which was issued by *The International Accounting Standards Board (IASB)* .

But the practical application of these standards raised some problems because of the existence of differences between the IAS and the GAAP, so as a result the IASB started to issue a new set of accounting standards known as *The International Financial Reporting Standards (IFRS)* to be applied by all countries across the globe in a trial to harmonize these differences among accounting standards.

High quality global financial reporting standards have many advantages such as :

Enhancing the comparability of financial information , improving the efficiency of allocating and pricing capital , facilitating cross-border trading and finally removing the need for jurisdictions to find resources to develop their own national standards .

Recently new category of corporations started to emerge , known as : ***Small and Medium – Size Entities (SMEs)*** ,which are characterized by : the lack of public accountability (i.e. they do not issue debt, equity or other instruments in a public market and they do not hold assets in a fiduciary capacity for a broad group of outsiders as : banks and insurance companies) , lower number of employees and limited funds and capital available for financial and investment operations .

[Pacter , 2009 , P:5-7 ; Di Pietra et al , 2008 , P:30-32 , Stainbank , 2008 , P:6 , Mullerova et al , 2010 , P: 59] .

In the global economic environment which is characterized by continuous structural changes and increasing competitive pressure , SMEs play an important role in sustaining the economic growth and development , as they are considered to be the driving force of the sphere of business , growth , innovations and competitiveness in many ways such as : providing social security and limiting the phenomenon of unemployment , enhancing the added value of the national income , creating new entrepreneurship and finally achieving effective utilization of regional resources, So as a result governments all over the world started to focus on the development of the SME sector in order to promote economic growth .

Since financial information has direct influence on SMEs' performance as it provides all the necessary data on key operational matters with guidelines for controlling the resources of the firm which in turn help entities to make effective decisions to enhance their performance , therefore many regulatory authorities and accounting standard setters started to draw more attention towards the information needs and the accounting practices adopted by SMEs as they constitute great percentage of the economic structure of many countries all over the world .

Because there are not any accounting standards specialized to be applied by SMEs in preparing their financial reports , they started to adopt the accounting standards set for larger entities such as : GAAP , IAS and the full IFRS , but the practical application of those standards has resulted in many problems to SMEs due to differences in characteristics and information needs between those SMEs and larger entities , taking for example : higher compliance costs and operational complexity associated with the application of the US GAAP or the IFRS , in addition to excessive disclosure requirements , all these factors impose a significant burden on SMEs that exceeds the benefits associated from it , which is known as [**accounting standards overload**] , lack of adequate financial information that enable the outside investors to assess their performance, absence of adequate accounting controls , difficulty in obtaining funds and credit from banks and other financial institutions and finally the low level of education and accounting knowledge and experience of SMEs' owners- managers and employees .

There were many trials adopted by many regulatory authorities in order to help SMEs to overcome their problems , taking for example :

A) The application of "Differential Reporting " : where SMEs are permitted to be exempted from the complete application of the accounting standards and the full disclosure requirements existing in the accounting standards in preparing their financial reports .

B) The issuance of the UK accounting standard : The Accounting Standards Board (ASB) in the UK has issued in June 2008 ***The Financial Reporting Standard For Smaller Entities (FRSSE)*** to be applied by SMEs in the UK , the FRSSE is a cut down version of accounting standards that were mainly issued to be applied by larger entities , it includes simplified accounting treatments and disclosure requirements tailored for the needs of SMEs .

C) The IASB issued a new accounting standard in July 2009 titled [The International Financial Reporting Standard For Small and Medium – Sized Entities (IFRS for SMEs)]

it represents a simple , high – quality , understandable and enforceable system of accounting standards suitable for SMEs worldwide in order to reduce the financial reporting burden on SMEs , as it will result in high quality financial information that help users of SMEs' financial statements to better assess the performance of the entity .

[Pacter , 2009 , P:5-8 ; Siam and Rahahleh , 2010 , P:21-24 ; Okpara and Kabongo , 2009 P:7-8; Di Pietra et al , 2008 , P:32-38 ; Vasilescu , 2009 , P:311 ; Stainbank , 2008 , P:7 ; Kang and Heshmati , 2008 , P: 445 , Sarapaivanich and Kotey , 2006 , P:222] .

Comment :

The researcher in the following chapters will consider all the problems faced by SMEs that hamper their performance and development in detail in addition to all the trials that were adopted by governments to overcome those problems and any contradictions made to those trials with more focus on the problems that have direct influence on accounting and financial reporting for SMEs .

1/2 : Research problem :

The Egyptian SMEs suffer from lack of unified accounting standards tailored to their needs from accounting and financial information to prepare high quality and reliable financial reports , therefore they are adopting the Egyptian Accounting Standards which proved to be unsuccessful as their application has resulted in many problems such as :

- The Egyptian Accounting Standards are complex and characterized by excessive disclosure requirements and therefore impose very high compliance costs to be afforded by most of SMEs which affected negatively the performance of those entities .
- The managers and owners of SMEs lack the necessary accounting and financial expertise therefore , it is difficult for them to understand and apply the complex and excessive disclosure requirements existing in the standards .
- Non- existence of adequate financial information which helps investors and other financial statements' users in assessing the entity's performance and taking financial and investment decisions .
- Lack of adequate accounting controls.
- Lack of access of capital because of the difficulties they face in obtaining funds and credit from banks and other financial institutions that are necessary for their growth .

This problem raises some important questions:

- Can the new standard (IFRS for SMEs) help the Egyptian SMEs to overcome their accounting problems ?
- Will the application of the new standard (IFRS for SMEs) in the Egyptian economy result in higher quality financial reports?
- Will the new standard provide the investors and other users of financial statements of the Egyptian SMEs with adequate financial information that help them assess the entity's performance?
- Will the application of the new standard result in lowering the compliance costs associated with applying The Egyptian Accounting Standards ?
- Will the new standard help in making investment decisions in SMEs?

1/3 : Research Objectives:

The main objective of this research is: to try to solve the accounting problems faced by the Egyptian SMEs .

There are **secondary objectives** should be accomplished to reach to the main objective:

- Study the financial information needs of SMEs.
- To analyze the main differences between the new standard (IFRS for SMEs) and the Egyptian accounting standards and test the effect of its application on the financial reports of the SMEs.
- To see if the application of the new standard will provide the investors and creditors with adequate financial information that helps them to assess the entity's performance.

1/4 : literature review :

This section summarizes the related previous studies that examined the problems faced by SMEs in different countries .

(1) Study of طارق حماد (2002) :

Title : منهج محاسبي مقترح لإعداد تقارير مالية تلائم المنشآت الصغيرة .

Purpose :

- To analyze the problems resulting from the preparation of financial reports in small entities and to introduce the idea of applying the differential reporting , where those entities are exempted from the complete application of accounting standards .

Small non- publicly accountable entities suffer from accounting standards overload where the excessive disclosure requirements in the accounting standards results in small entities incurring high compliance costs in preparing their financial reports exceed the expected benefits rendered to their users .

Results :

It introduced an accounting model and guidelines for applying the differential reporting .

Researcher opinion :

Differential reporting is not beneficial to be applied in small entities , because it did not satisfy the comparability and reliability requirements in preparing their financial reports .

(2) Study of De Gobbi (2003) :

Title : Mutual Guarantee Associations for small and micro – entrepreneurs : lessons learned from Europe and Africa .

Purpose :

- To discuss the idea of Mutual Guarantee Associations as a solution to the problem of access to credit from banks faced by small and micro – entrepreneurs who cannot offer sufficient capital.

Small entrepreneurs cannot access credit from traditional banks due to lack of sufficient collateral and lack of high quality information that enable banks to assess their creditworthiness.

Results :

Mutual Guarantee associations can be effective in helping small and micro – entrepreneurs to gain access to credit from financial institutions .

Researcher opinion :

Small entrepreneurs need to maintain proper accounting system that produces financial reports with qualified information which therefore could help banks in assessing their performance and could facilitate the work of the Mutual Guarantee Associations .

(3) Study of Wang (2004) :

Title : Financing conditions and institutional failure of small and medium- sized enterprises financing in transitional China .

Purpose :

- To discuss the definitions , characteristics and problems facing SMEs in China .

SMEs in China suffer from credit rationing , as banks are unable to properly assess their creditworthiness due to lack of reliable information on their financial conditions and performance .

Results :

In order to promote SMEs' financing , government should make efforts to reform the financing system for SMEs .

To improve the process of external financing of SMEs , some regulations should be established such as : improving both the credit guarantee system and credit information system for SMEs in addition to stimulating the formation and development of investment funds and venture capital .

Researcher opinion :

SMEs in China need to apply accounting standards that result in producing high quality financial reports that enable banks to assess the entity's performance and therefore helping to overcome the problem of information asymmetries and facilitating SMEs access to credit .

(4) Study of Christopher et al (2005) :

Title : Little GAAP : a practitioner perspective .

Purpose :

- It is concerned with the issue of whether the accounting standards applied by large publicly- traded enterprises could be applied by SMEs .

SMEs staff lack the necessary financial and accounting expertise and therefore they must rely on CPAs to prepare their financial statements .

Financial statements prepared in conformity with GAAP are costly and include information that do not meet the users' needs .

Results :

The practitioners addressed the need for accounting profession to focus on SMEs and their financial reporting needs .

Researcher opinion :

SMEs need to apply accounting standards that meet their financial reporting needs and result in high quality financial reports at lower costs that may help to solve the problems they face .

(5) Study of Maingot and Zeghal (2006) :

Title : Financial reporting of small business entities in Canada .

Purpose :

- To examine whether small business entities in Canada should have their own set of GAAP or continue to use the big GAAP adopted by larger companies .
- It proposes three models of accounting standards to be adopted for preparing financial statements in small business entities : a single set of GAAP for all organizations (large and small) , differential reporting and finally two sets of GAAP (one big GAAP for large organizations and another little GAAP for smaller entities) .

Small business entities in Canada suffer from accounting standards overload and high compliance costs .

Results :

Stakeholders indicated that financial statements of small business entities are prepared mainly for taxation purposes and borrowing , moreover they are not satisfied with the present accounting standards because they are costly to implement and complex and the burden of producing small business entities financial statements can be reduced by simplifying the present standards .

Researcher opinion :

The adoption of differential reporting in small business entities is not beneficial , because it did not satisfy the comparability and reliability requirements for preparing financial reports , however those entities need to adopt accounting standards with simplified requirements tailored to their needs that will result in producing high quality financial reports at lower costs , thereby solving the problem of accounting standards overload .

(6) Study of Green et al (2006) :

Title : Finance for small enterprise growth and poverty reduction in developing countries .

Purpose :

- To examine the ways in which financial sector development policy can contribute to poverty reduction by supporting the growth of micro and small enterprises in developing countries .

The growth and development of micro and small enterprises in developing countries were inhibited by : access to finance , poor management skills , lack of training opportunities and high costs of inputs .

Inadequate access to credit from formal financial institutions is recognized as constraint for the expansion of micro and small enterprises sector .

Results :

The growth of micro and small enterprises can contribute to poverty reduction , however it is mainly impeded by lack of access to finance .

Researcher opinion :

The problem of access to finance of micro and small enterprises can be solved by adopting accounting standards that results in high quality financial information that enable financial institutions to assess the creditworthiness of those enterprises .