UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

ACCOUNTING AND FINANCIAL REPORTING GUIDELINES FOR SMALL AND MEDIUM-SIZED ENTERPRISES (SMEGA)

LEVEL 3 GUIDANCE

UNITED NATIONS

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

ACCOUNTING AND FINANCIAL REPORTING GUIDELINES FOR SMALL AND MEDIUM-SIZED ENTERPRISES (SMEGA)

LEVEL 3 GUIDANCE

UNITED NATIONS
New York and Geneva, 2003

NOTE

Symbols of United Nations documents are composed of capital letters combined with figures. Mention of such a symbol indicates a reference to a United Nations document.

The designations employed and the presentation of the material in this publication do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area, or of its authorities, or concerning the delimitation of its frontiers or boundaries.

UNCTAD/ITE/TEB/2003/6

UNITED NATIONS PUBLICATION

Sales No. E.04.II.D.15

ISBN 92-1-112622-3

CONTENTS

Preface

At its 17th session in July 2000, the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) identified a number of obstacles that small and medium-sized enterprises (SMEs) were facing in applying accounting standards that had been issued by various standard-setting bodies, both national and international. It was agreed that a project should be undertaken to identify possible approaches that would meet the accounting and financial reporting needs of such enterprises.

ISAR has supported the International Accounting Standards Board (IASB) as the international standard setter of reference for accounting and reporting standards. The standards (IASs) issued by the IASB, however, have been created largely with the financial reporting needs of listed companies in mind. Consequently, it has often been difficult to apply them to SMEs, particularly those in developing countries and countries with economies in transition. For many businesses in these countries professional help may also be disproportionately expensive.

In order to meet the financial reporting needs of SMEs, ISAR is proposing that a three-tiered structure be adopted, as follows:

Level 1. This level would apply to listed enterprises whose securities are publicly traded and those in which there is significant public interest. These enterprises should be required to apply the accounting and financial reporting standards (IASs and IFRSs) issued by the IASB.

Level 2. This level would apply to significant business enterprises that do not issue public securities and in which there is no significant public interest. ISAR has developed a single set of requirements that have been derived from the IASs issued by the IASB, but embodying only requirements for the most regularly encountered transactions. This level would still have the option to follow the full set IASs and IFRSs issued by the IASB.

Level 3. This level would apply to the smallest entities that are often owner-managed and have few employees. The approach proposed is a simple accruals-based accounting, based on that set out in international accounting standards, but closely linked to cash transactions. National regulators may permit a derogation for newly formed businesses or new entrants to the formal economy to use cash accounting for a limited time.

How exactly the boundaries between the three levels should be specified is a matter that cannot be dealt with adequately without knowledge of the specific economy in which the enterprises operate. The recommendation of ISAR is that there should be a system with at least three levels, but how these levels are defined must be determined by each member State that chooses to apply this approach, taking into account the prevailing economic, legal and social circumstances, particularly the member State's enterprise structure.

The SMEGA-Level 3 that ISAR has developed is set out in the material that follows.

Introduction

1. The SMEGA for Level 3 is designed for financial statements of small enterprises that are owner-managed and have few employees. Such enterprises should generally follow a simple accruals-based accounting system that is closely linked to cash transactions.[1]

Scope

2. Level 3 enterprises typically have significant difficulties in accessing bank and trade credit. They are likely to be one-person enterprises or businesses with few employees. The SMEGA for Level 3 is intended to meet the needs of users and preparers of financial statements for these enterprises.

Components of financial statements

3. A set of financial statements for Level 3 enterprises includes the following components:

(a) an income statement;

(b) a balance sheet; and

(c) explanatory notes.

Level 3 accounting framework

4. The two financial statements – the income statement and the balance sheet – are based on a simple accruals accounting approach broadly consistent with IAS 1. The guidance requirements do not involve compliance with specific IASs but are based on the historical cost and accruals measurement approach, which is the basis of IASs. To ensure that the Level 3 financial statements are part of a coherent framework within the three levels, Level 3 guidance rules are linked with those for Level 2 and IASs.

---

[1] National regulators may permit a derogation for newly formed businesses or new entrants to the formal economy to use cash accounting for a limited time.

5. Level 3 statements will normally be prepared on the assumption that an enterprise is a going concern and will continue in operation for the foreseeable future (see paragraph 24).

The objectives of Level 3 financial statements

6. The objective of Level 3 financial statements is to provide information about the reporting enterprise's financial performance and financial position that will be useful to users in assessing the performance of the enterprise and the stewardship of the enterprise's management.

Users and their needs

7. The objective of financial statements is to help develop the business by providing useful information to users. Therefore, the statements are designed to reflect user needs. Evidence suggests that the principal users of financial statements of Level 3 enterprises are likely to be:

(a) management;

(b) lenders and other creditors;

(c) government;

(d) taxation authorities; and

(e) SME agencies.

8. The following is a summary of the likely needs of these users:

Management: