

## **The required information and financial statements disclosure in SMEs**

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### **ABSTRACT**

This study aimed to determine the nature, the requirements of financial disclosure in small and medium enterprises (SMEs) in comparison with large corporations in Jordan. It also aimed to investigate the need for a special International Accounting Standard for small and medium enterprises (SMEs in Jordan).

To achieve the objectives of the study, a fifty - item questionnaire has been designed based on the disclosure literature. This questionnaire contained information that must be disclosed in published financial statements which are prepared according to International Financial Reporting Standards.

This study points out that there is a significant difference between SMEs and large corporations in terms of the materiality of the required disclosure in the income statement. The percentage of the important items that should be disclosed in SMEs was 40%, and it was 90%, in the large corporations. For the financial position statement they were 31%, & 82%, respectively, and for the statement of changes in owners' equity they were 14%, & 43% respectively. Finally for the cash flow statement the two percentages were same and it was 100%. Moreover, the majority of the study sample (76%) supports the need for special standard which organize the disclosure in SMEs.

The nature and the extent of the disclosure in SMEs financial statements have been given more importance. This study is the first of its kind that explored the requirements of financial disclosure in SMEs in comparison with large corporations in Jordan. Also to encourage SMEs to improve the efficiency of their accounting and control systems, which increase the efficiency of their financial and administrative reports. This will provide more transparency and disclosure in their financial data.

**Keywords:** Small & Medium Enterprise, Financial Disclosure, International Financial, Financial Statement.

## 1.0 Introduction

The small and medium enterprises (SMEs) play a significant role in the economy of countries, notably the developing countries. According to the Department of Statistics in Jordan (DOS, 2012), the number of employees in the SMEs in Jordan is about 16% of the Jordanian labor force. Furthermore, the gross capital employed in the SMEs doubled three times to reach 680 million JD in 2012, which equals only 4.3% of the gross capital employed in all Jordanian entities. Consequently, the nature and the extent of the disclosure in SMEs financial statements have been given more importance. In its classification of the SMEs and large enterprises, the Ministry of Industry and Trade (MIT) in Jordan has used the standards of the invested capital volume in addition to the standard of employment, as in Table 1.

**Table 1: Standards of Classifying Small & Medium Enterprises in Jordan**

N	Type of entity according to the size	Number of employees	Volume of invested capital
1.	Micro	Less than 10	Less than 30000JD
2.	Small	10-49	Less than 30000JD
3.	Medium	50-249	More than 30000JD

Sources: *The Statistical Reports of Amman Trade Chamber, 2007*

## 1.1 Problem and Questions of the Study

The problem which comes to the surface is the controversy of the nature and the extent of the disclosure required in the financial statements published by the SMEs. This controversy focuses on two questions:

1. Are there significant statistical differences between the disclosed financial data issued by SMEs and those issued by large corporations from the point of view of data users? This question is subdivided into the following questions:
  - a) Do the nature and the extent of the disclosure required in income statements published by SMEs differ from those of large corporations?
  - b) Do the nature and the extent of the disclosure required in the statement of financial position published by SMEs differ from those of large corporations?
  - c) Do the nature and the extent of the disclosure required in the statement of changes in equity published by SMEs differ from those of large corporations?
  - d) Do the nature and the extent of the disclosure required in the cash flow statement published by SMEs differ from those of large corporations?
  - e) Do the nature and the extent of the disclosure required in footnotes and illustrations attached to the financial statements published by SMEs differ from those of large corporations?
2. Do the standards of the International Accounting Standards of SMEs satisfy the needs of the SMEs financial data users?

Consequently this study aims at forming a framework for the nature and the extent of the disclosure required in the SMEs financial data in comparison with the extent and the nature of the large corporations' financial data.

## 1.2 Objectives of the Study

The main objectives of this study are:

1. The definition of the SMEs and the determination of the standards which distinguish these entities from large corporations, and pointing out the importance of SMEs in the Jordanian economy.

2. The recognition of the nature and the extent of the disclosure required in the SMEs published financial data compared with large corporations. Then, the investigation of special standards for SMEs.
3. The investigation of the disclosure standards in the international accounting standards to find out whether these standards satisfy the needs of data users.

### 1.3 Hypotheses

- H<sub>01</sub>: There are no significant statistical differences between the nature and the extent of the disclosure required in the income statement of the SMEs and large corporations.
- H<sub>02</sub>: There are no significant statistical differences between the SMEs and large corporations in the nature and the extent of the disclosure required in the statement of the financial position.
- H<sub>03</sub>: There are no significant statistical differences between the SMEs and large corporations in the nature and the extent of the disclosure required in the statement of changes in equity.
- H<sub>04</sub>: There are no significant statistical differences between the SMEs and large corporations in the nature and the extent of the disclosure required in the equity and cash flow statement.
- H<sub>05</sub>: There are no significant statistical differences between the SMEs and large corporations in the nature and the extent of the disclosure required in the footnotes and illustrations attached to the financial statements.

### 2.0 The Disclosure in the Financial Data of the SMEs

The researchers have two major questions: the first is when publishing their financial statements, should the SMEs data be similar to those statements of large entities? The second question, are the standards applied in the disclosure of SMEs financial statements the same as those of large corporations?

Previous researchers agreed on the exemption of SMEs of the mandatory disclosure publishing required form large corporations for the following reasons (Greenstone and Paul, 2006):

1. The cost of issuing the financial data is relatively high, the thing that does not meet with the financial and economic potentials of the SMEs.
2. The SMEs published data usually address the suppliers and the owners of these entities. However, when the financiers request these data; special financial reports can be introduced to them directly without publishing.

The second question which is related to the extent and level of the disclosure required form SMEs in their financial statements. There has been a wide controversy among literature review since the 1980s. Therefore, the AICPA (1981) has formed a special committee which investigated this issue in the light of two major elements:

1. The role of the accounting as an information system and do the users of SMEs financial data need the same level of the disclosure as large corporations data users?
2. Following the Modern Information Theory, the accounting information has a financial cost as any other commodity. Consequently, the extent of the disclosure should not exceed in its cost the fulfilled outcomes of the financial data users.

Depending on these bases, the disclosure of important data should be introduced in the correct time in the core of the financial statements and each in a separate item. As for the details, they can be introduced in the appendix according to the rating level standards. In

contrast to the voluntary disclosure, the mandatory disclosure raises the accuracy of evaluating these risks and so the cost of loans will decrease.

### 3.0 Methodology

The questionnaire's items have covered the main financial statements: The income statement, the statement of the financial position, the statement of changes in equity, the cash flow statement and the appendices and the illustrations attached to the financial statements. The questionnaire was distributed to three categories of respondents: credit analysts, credit managers and credit officers who are working in ten commercial banks in Jordan. This study was analyzed by Cronbach's  $\alpha$  test to ensure the ability of the study to fulfill its objectives. The alpha confidence level was 94.5% which exceeds the acceptable statistical criteria which is 60% (Sekaran, 2003, p.225). To test the objectivity of the study and its consistency of the data with the requirements of normal distribution and the lack of statistical mistakes, results were examined by the test of Kolmogorov-Smirnov with a significance level (0.05). The obtained results are summarized in Table 2.

**Table 2: The Normal Distribution of the Study Variables**

N	Variables	Kolmogorov-Smirnov	Sig *	Result
1.	Income statement	1.051	0.219	Follow normal distribution
2.	Balance sheet	0.918	0.369	Follow normal distribution
3.	Statement of changes in equity	0.733	0.657	Follow normal distribution
4.	Cash flow statement	1.011	0.259	Follow normal distribution
5.	Footnotes& illustrations of the financial statement	0.879	0.422	Follow normal distribution
	Average of Variable	94.5	0.325	Follow normal distribution

\* If significance level > 0.05, the distribution is normal

### 4.0 Data Analysis

After analyzing the answers of the questionnaire, data were clarified in the following tables according to the following relative weights: very important 4.5-5, important 3.75-4.5, medium 3>3.75, weak 2>3, not important >2.

#### 4.1 The Income Statement

**Table 3: The Rating Level of Disclosure Items in the Income Statement**

N	Information items	Small& medium entities			Large corporations		
		Mean	Standard deviation	Rating level	Mean	Standard deviation	Rating level
1.	Sales Revenue	4.38	0.66	important	4.43	0.83	important
2.	operating Activity profit/loss	4.45	0.80	important	4.38	1.08	important
3.	Depreciation in a separate item	2.88	0.89	weak	3.76	0.93	important
4.	Financing cost in a separate item	3.88	1.25	important	4.40	0.99	important
5.	Profit/loss of discontinued operations in a separate item	3.36	1.34	weak	3.95	1.15	important
6.	Extraordinary items	2.79	1.34	weak	3.17	1.34	medium
7.	Post-tax Profit/loss in the fund accounting period.	4.38	0.82	important	4.26	1.19	important
8.	Profit/Loss of investment held for trading	2.88	1.14	weak	3.88	1.35	important
9.	Loss/gain recognized on disposal of assets or disposal groups.	3.12	1.32	medium	4.38	0.79	important
10.	Share of profit/loss of associates & joint ventures.	3.33	0.48	medium	4.09	0.53	important
General average & standard deviation		3.55	0.48	medium	4.09	0.53	important

Data in Table 3 indicate the following:

- 1) When treated as one unit, the relative weight of the disclosed data in the income statement varies according to the type of the borrower entity. These data are important with an average of 4.09 for large entities while it has a medium importance of an average of 3.55 for SMEs.
- 2) When treated as separate items, we find that 90% of these items are important if the borrower entity is large. While 40% of the items are important if the entity is small or medium.

## 4.2 The Statement of the Financial Position

**Table 4: Reveals the Rating Level of the Disclosure Items in the Statement of the Financial Position**

N	Information items	Small& medium entities			Large corporations		
		Mean	Standard deviation	Rating level	Mean	Standard deviation	Rating level
1.	Cash& cash equivalents	4.40	0.89	important	4.43	0.80	important
2.	Doubtful accounts	3.62	0.85	medium	4.07	1.02	important
3.	Accounts receivables	4.12	1.02	important	4.45	0.89	important
4.	Creditors receivables	2.43	1.13	weak	3.05	1.15	medium
5.	Type of Inventories	3.67	1.14	medium	4.19	1.21	important
6.	Investments carried at fair value	3.48	0.99	medium	4.07	1.20	important
7.	Biological assets at cost less accumulated depreciation & impairment	3.00	1.15	medium	4.00	1.17	important
8.	Intangible assets excluding impairment	2.64	1.01	weak	3.55	1.11	medium
9.	Current or short-term liabilities	3.76	1.45	important	4.36	0.93	important
10.	Non-current liabilities	3.69	0.90	medium	4.40	0.77	important
11.	Equity	4.26	1.11	important	4.45	1.11	important
12.	Minority rights	2.69	1.28	weak	3.74	1.04	medium
13.	Amortized portion of lease financing obligation	3.05	1.10	medium	3.55	1.09	medium
14.	System accounts	3.76	1.23	important	4.19	1.35	important
15.	Differences re-submission of investments available for sale in a separate section within the rights of owners	3.21	1.32	medium	4.00	1.13	important
16.	Differences revaluation of investments held to maturity, while in a separate section within the rights of the owners.	2.88	1.37	medium	3.79	1.35	important
General average & standard deviation		3.42	0.48	medium	4.02	0.57	important

Data in Table 4 indicate the following:

- 1) The relative weight of the disclosed data in the statement of the financial position for large entities is more than the SMEs if items are treated as one unit. The disclosed data is important with an average of 4.2% for large entities, whereas the Mean is 3.42% for SMEs and with medium importance.
- 2) When analyzing each item of the disclosure separately, we notice that 82% of these items are considered important in the financial data for the large entities, while the important items do not exceed 31% of the items in SMEs financial data. The importance of other items ranges from medium importance with 50% of the items to weak importance with 19% which includes the following items:

### 4.3 The Statement of Changes in Equity

**Table 5: The Rating Level of the Items Disclosed in the Statement of Changes in Equity**

N	Information items	Small & medium entities			Large corporations		
		Mean	Standard deviation	Rating level	Mean	Standard deviation	Rating level
1.	Additional paid-in capital	4.26	1.04	important	4.60	0.80	very important
2.	Retained earnings at the beginning & end of period	3.79	1.12	medium	4.07	1.00	important
3.	Accumulative effect of changes in accounting policy	2.93	1.00	weak	3.79	1.16	important
4.	The impact of correcting basic errors of previous years.	2.98	1.05	weak	3.90	0.98	important
5.	Minority rights	2.79	1.35	weak	3.74	1.23	medium
6.	Gains or unrealized losses from the revaluation of investments held for sale.	3.33	1.51	medium	3.74	1.19	medium
7.	Gains or unrealized losses from the revaluation of investments held until maturity.	3.19	1.49	medium	3.71	1.29	medium
General average & standard deviation		3.32	0.66	medium	3.94	0.74	important

Table (5) clarifies the following points:

1. The relative weights of the disclosed data in the statement of changes in equity are less than the relative weights of the data disclosed in the income statement and the statement of the financial position (either taken separately or as a whole unit).
2. 57% of the items are important for large entities. The rest is of medium importance with 43% of the items. As for SMEs, however, the important items are 14% while the 86% of the items are of medium or weak importance.

#### 4.4 The Cash Flow Statement

**Table 6: The Rating Level of the Disclosure of the Items in the Cash Flow Statement**

N	Information items	Small& medium entities			Large corporations		
		Mean	Standard deviation	Rating level	Mean	Standard deviation	Rating level
1.	Increase/decrease in the working capital	3.83	1.27	important	4.38	1.08	important
2.	Cash receipts from royalties, fees, commissions& other revenue.	4.02	1.26	important	4.43	1.11	important
3.	Cash receipts from investment	3.76	1.25	important	4.21	1.09	important
4.	Cash receipts from sale & rendering of service	4.05	1.16	important	4.37	1.04	important
5.	Cash receipts from other contracts	3.88	1.10	important	4.20	0.95	important
General average & standard deviation		3.91	0.89	important	4.31	0.76	important

Table (6) shows the following:

1. As the cash flow statement is considered the corner stone of taking the credit decision, the study sample pay a greater attention to the disclosure of the data in this statement items for small, medium and large entities.
2. The results show that all items of the statement are 100% important for both kinds of entities. Moreover, the rating level of the data of this statement, whether taken as whole or separate items, is more for large entities than for the SMEs.



#### 4.5 The disclosure in the footnotes and the illustrations attached to the financial statements

**Table 7: The Relative Weights of the Disclosed Data in the Footnotes and Illustrations Attached To the Financial Statements**

N	Information items	Small& medium entities			Large corporations		
		Mean	Standard deviation	Rating level	Mean	Standard deviation	Rating level
1.	Accounting requirements of financial data	3.63	1.09	medium	4.29	0.81	important
2.	Standards in preparing financial data	3.27	0.92	medium	4.00	1.10	important
3.	Method used to evaluate the inventory of goods and investments.	3.39	0.89	medium	3.88	1.17	important
4.	The method used in the treatment of gains or losses on revaluation of investment securities.	3.30	0.97	medium	4.05	1.11	important
5.	The method used in the treatment of gains or losses assessment of investments in real estate.	3.27	1.16	medium	4.05	1.05	important
6.	Equipment depreciation	3.05	0.99	medium	3.80	0.99	important
7.	Changes in accounting policy	3.61	1.02	medium	3.98	1.11	important
8.	Contingent liabilities	4.15	1.20	important	4.44	0.87	important
9.	Commitments to contracts in force that will affect future periods	3.59	1.09	medium	4.17	0.74	important
10.	Loans& guarantees schedule	4.10	1.14	important	4.12	1.23	important
11.	Deals with related parties	2.85	1.15	weak	3.71	1.31	Medium
12.	Social accountability	2.24	1.22	weak	3.49	1.15	important
General average & standard deviation		3.40	0.51	medium	4.03	0.66	important

Tables (7) sheds the light on the valuation of the relative weight of the disclosure required in the footnotes and attached illustration of the financial statement:

1. Similar to the financial statements, items in the footnotes and attached illustrations have more importance in large entities than in the SMEs, either these items taken as a whole or separately.
2. As a whole unit, data provided in the footnotes and attached illustrations of the financial statements are important with an average of 4.3 for large entities while it is considered of medium importance with an average of 3.4 for the SMEs.
3. When taken as separate items, 92% of the items are important for large entities, while 60% are important for the SMEs.

#### 4.6- The disclosure in the financial statements

**Table 8: The Rating Level of the Data Provided By the Financial Statements When Items Are Taken As a Whole Unit**

N	Information items	Small& medium entities			Large corporations		
		Mean	The rating level	Rank	Mean	The rating level	Rank
1.	The income statement	3.55	Medium	2	4.09	important	2
2.	The statement of the financial position	3.42	Medium	3	4.02	important	4
3.	The statement of changes in equity	3.32	Medium	5	3.94	important	5
4.	The cash flow statement	3.91	important	1	4.31	important	1
5.	The footnotes & illustrations attached	3.40	Medium	4	4.03	important	3
6.	All financial data	3.52	Medium		4.08	important	

Table (8) indicates the following:

- 1) The respondents think that all items in all the statements published by large entities are important while they are important in the cash flow statement for the SMEs. However, for the other statements the disclosure has medium importance.
- 2) The order of the financial statements published by the SMEs according to their rating level is as follows: the cash flow statement, the income statement, the statement of the financial position, the attached footnotes and illustrations and then comes the statement of changes in equity. As for large entities, the cash flow statement ranks also first, and then comes respectively: the income statement, the attached footnotes and illustrations, the statement of the financial position and the statement of changes in equity.

#### 5.0 Hypotheses Test

The results of this test were as follows:

**1) the first null hypothesis  $H_{01}$  states that:** "There are no significant statistical differences between the nature and the extent of the disclosure required in the income statement of the SMEs and large entities." Table 9 shows the (t) results of this hypothesis.

**Table 9: (T) Test Results of the First Null Hypothesis  $H_{01}$  of the Income Statement**

Hypothesis	Type of entity	Mean	The standard deviation	Calculated T value	Tabular	SIG of T value	Result
$H_{01}$	Small/medium entity	3.55	0.48	6.886	1.684	(*) 0.00	rejection
	Large corporation	4.09	0.53				

(\*)(Significance level equal or less than 0.05)

According to the decision rule of (t) test, the  $H_{01}$  is rejected as the calculated (t) value was 6.886 which is greater than the tabulated (t) value (1.684). Moreover, SIG value (0.000) is less than the significance level of the test (0.05). So there is a statistical significant difference between the nature and the extent of the disclosure required in the income statement of the large corporations and the disclosure required in the income statement of the SMEs.

**2) The second null hypothesis  $H_{02}$  states that:** "There are no significant statistical differences between the SMEs and large corporations in the nature and the extent of the disclosure required in the statement of the financial position." Table 10 shows the (t) results of this hypothesis.

**Table 10: (T) Test Results of the Second Null Hypothesis H<sub>02</sub> of the Statement of the Financial Position**

Hypothesis	Type of entity	Mean	The standard deviation	Calculated T value	Tabular	SIG of T value	Result
H <sub>02</sub>	Small/medium entity	3.42	0.48	7.430	1.684	(*) 0.00	rejection
	Large entity	4.02	0.57				

(\*)(Significance level equal or less than 0.05)

According to the decision rule of (t) test, the H<sub>02</sub> is rejected as calculated (t) value was 7.430 which are greater than the tabulated (t) value (1.684). Moreover, SIG value (0.000) is less than the significance level of the test (0.05). So there is a statistical significant difference between the nature and the extent of the disclosure required in the statement of the financial position for the large corporations and the disclosure required in the statement of the financial position for the SMEs.

**3) The third null hypothesis H<sub>03</sub> states that:**" There are no significant statistical differences between the SMEs and large corporations in the nature and the extent of the disclosure required in the statement of the changes in equity." Table (11) shows the (t) results of this hypothesis.

**Table 11: (T) Test Results of the Third Null Hypothesis H<sub>03</sub> of the Statement of Changes in Equity**

Hypothesis	Type of entity	Mean	The standard deviation	Calculated T value	Tabular	SIG of T value	Result
H <sub>03</sub>	Small/medium entity	3.32	0.66	4.647	1.684	(*) 0.00	rejection
	Large entity	3.94	0.74				

(\*)(Significance level equal or less than 0.05)

According to the decision rule of (t) test, the H<sub>03</sub> is rejected as calculated (t) value was 4.647 which is greater than the tabulated (t) value (1.684). Moreover, SIG value (0.000) is less than the significance level of the test (0.05). So there is a statistical significant difference between the nature and extent of the disclosure required in the statement of changes in equity for the large corporations and the disclosure required in the statement of changes in equity for the SMEs.

**4) The fourth null hypothesis H<sub>04</sub> states that:**" There are no significant statistical differences between the SMEs and the large corporations in the nature and the extent of the disclosure required in the cash flow statement. Table 12 shows the (t) results of this hypothesis:

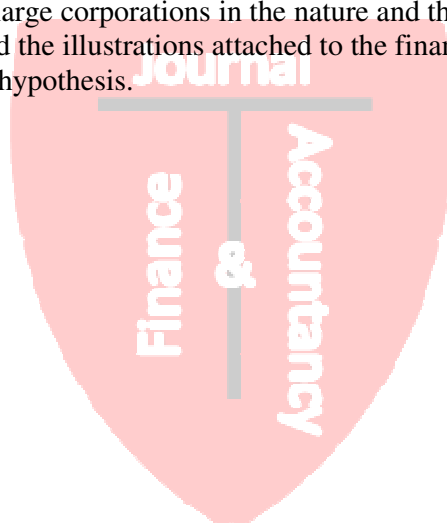
**Table 12: (T) Test Results of the Fourth Null Hypothesis  $H_{04}$  of the Cash Flow Statement**

Hypothesis	Type of entity	Mean	The standard deviation	Calculated T value	Tabular	SIG of T value	Result
$H_{04}$	Small/medium entity	3.91	0.89	1.275	1.684	(*) 0.073	acceptance
	Large entity	4.31	0.76				

(\*) (Significance level equal or less than 0.05)

According to the decision rule of (t) test, the  $H_{04}$  is accepted, contrary to the previous hypotheses tests, as calculated (t) value was 1.275 which is less than the tabulated (t) value (1.684). Moreover, SIG value (0.073) is greater than the significance level of the test (0.05). So there is no statistical significant difference between the nature and the extent of the disclosure required in the cash flow statement for the large corporations and the disclosure required in the cash flow statement for the SMEs.

**5) The fifth null hypothesis  $H_{05}$  states that:** " There are no significant statistical differences between the SMEs and the large corporations in the nature and the extent of the disclosure required in the footnotes and the illustrations attached to the financial statements. Table 13 shows the (t) results of this hypothesis.



**Table 13: (T) Test Results of the Fifth Null Hypothesis  $H_{05}$  of the Illustrations and Footnotes Attached To the Financial Statement**

Hypothesis	Type of entity	Mean	The standard deviation	Calculated T value	Tabular	SIG of T value	Result
$H_{05}$	Small/medium entity	3.40	0.51	6.110	1.684	(*) 0.000	rejection
	Large entity	4.03	0.66				

(\*) (Significance level equal or less than 0.05)

According to the decision rule of (t) test, the  $H_{05}$  is rejected as calculated t value was 6.110 which is greater than the tabulated t value (1.684). Moreover, SIG value (0.000) is less than the significance level of the test (0.05). So there is a statistical significant difference between the nature and the extent of the disclosure required in the footnotes and the illustrations attached to the financial statements for the large corporations and the disclosure required in the footnotes and the illustrations attached to the financial statements of the SMEs.

### 6.0 Conclusions and Recommendations

Here are the results' conclusions of the study:

- 1) In addition to their contribution in creating job opportunities, the SMEs play a significant role in the economic activities in Jordan.
- 2) The centralization of the administration of the SMEs, due to the familial ownership, affects the accounting, the internal control and the authorial systems negatively.
- 3) Except for some cases, the study points out the diversity in evaluating the rating level of the disclosure required from the SMEs and that of the large corporations when publishing their financial statements whether taken as a whole unit or divided into separate items.

In order to reinforce and encourage the SMEs to develop the national economy, researchers recommend:

- 1) Providing sufficient, moderate cost financial resources so as to support and expand the SMEs activities in the industrial, the commercial and the service fields.
- 2) Providing more tax exemptions on the SMEs productive earnings.
- 3) Providing sufficient training chances for the SMEs employees.
- 4) In order to get more owners of the household ownership, good regulations should be issued to encourage SMEs to merge and adapt the democratic administration which believes in the institutionalism.
- 5) Encouraging SMEs to improve the efficiency of their accounting and control systems, which increase the efficiency of their financial and administrative reports. This will provide more transparency and disclosure in their financial data.
- 6) Encouraging the harmony of these entities with the rules of the international financial reporting standard for the SMEs which was issued recently and approved in April 2009. The latter includes all measurements of the disclosure used in preparing and examining the SMEs financial data.

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