Small and Medium Entities (SMEs) contribute substantially to the economic growth of any country. Entrepreneurs of SMEs play a major role in economic and social development and they are the economic drivers. It is a global understanding and a duly recognized fact that the SME sector is a major contributing source to emerging economies.

SME sector contribution to various economies

Country	ESTABLISHMENTS (%)	EMPLOYMENT (%)	GDP (%)
Sri Lanka	80 – 90%	Above 70%	Above 70%
Japan (2006)	99.7	69.5	55.3
Singapore (2007)	90	56	42
Malaysia (2006)	99.2	56	32%

Source: Chandaria, M. 2007, Small and Medium Enterprise Workshop, Nairobi, Ministry of Finance and Planning

Having recognized the importance of the SME sector to any country, the **International Accounting Standards Board** (**IASB**) has introduced stand-alone accounting standards for SMEs. International Financial Reporting Standards (IFRS) for SMEs are applicable to SMEs when preparing and presenting financial statements. The need for application of common accounting standards is of no doubt to any person, especially accountants. However, maintenance of uniformity, comparability, improving the quality of financial information and their presentation, understandability, accuracy, and reliability are key advantages of using common accounting standards. IFRS, which is the fundamental standard that is nowadays applicable to any company, provides such common platform.

IFRS for SMEs were developed based on the full volume of IFRS, especially bearing in mind the nature of SMEs. In Sri Lanka, this will be adopted with effect from 1 January 2012 as Sri Lanka Financial Reporting Standards for SMEs (SLFRS for SMEs).

What is a SME? SME has no unique or single definition in national or international context. Many countries, institutes and persons have defined it in different ways to serve their own purpose. Generally, SME is defined in terms of capital investment and number employees.

In the absence of an exact definition, IFRS for SMEs have come up with its own definition for the convenience of its application. Defining SME is not an easy task because it varies from country to country, industry to industry and from time to time based on the stage of development, government policies and administrative set up of the particular country.

Nevertheless, SLFRS for SMEs has defined, that its standards can be applied only by entities that fulfil the following criteria; any entity ***(a) that does not have public accountability and (b) that does publish general-purpose financial statements for external users.***

However, what is public accountability is defined in the form of legitimate definition for decision-making purpose. Therefore, its complication is simplified. However, a contradiction takes place because of the explanatory note given for external users of financial statements as owners who are not involved in managing the business, existing and potential creditors and credit agencies. The statement for external party for owners is similar to owners of any public company (Listed or unlisted). However, this problem is relinquished due to the definition given to the public accountability, in which it says that

"An entity has public accountability if:

(a) Its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market or

(b) It holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities, brokers/dealers, mutual funds and investment banks.

It seems therefore that specific, most valid and applicable definition for SME to apply these standards is, ***the entity that does not have public accountability.***

This SLFRS SMEs further tends to explain that there are some entities that hold assets in a fiduciary capacity for a group of outsiders because they are entrusted by the clients, customers or members who do not involve the business, but expect the business to manage financial resources on behalf of them. However, if they do the business with that intention for reasons incidental to the primary business that does not mean that the entity is publicly accountable to produce financial statements. There are few examples given by the standard for easy understanding purpose such as travel or real estate agents, schools, charitable organisations and co-operative enterprises.

Further, SLFRS for SMEs has introduced following companies that are falling under the section 5 of the Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995 as companies that do not fall under the definition of SME as per SLFRS for SMEs.

-Companies licensed under the Banking Act, No. 30 of 1988

-Companies authorized under the Control of Insurance Act, No. 25 of 1962, to carry on insurance business

-Companies carrying on leasing business

-Factoring companies

-Companies registered under the Finance Companies Act, No. 78 of 1988

-Companies licensed, under the Securities and Exchange Commission Act, No. 36 of 1987, to operate unit trust

-Fund Management companies

-Companies licensed under the Securities and Exchange Commission Act, No. 36 of 1987, to carry on business as stock brokers or stock dealers

-Companies licensed under the Securities and Exchange Commission Act, No. 36 of 1987, to operate a Stock Exchange

-Companies listed in a Stock Exchange licensed under the Securities and Exchange Commission Act, No 36 of 1987

-Public corporation engaged in the sale of goods or the provision of services

Benefits of Applying SLFRS for SMEs

There are numerous benefits that SMEs can have by applying these standards when preparing their financial statements. Before finding out what these benefits are, it is worthwhile analyzing why specific accounting standards that are particularly applicable to SMEs have been developed. SMEs are by nature small and medium in their size. Their resources, capabilities and capacities are therefore limited when compared with large organizations. SMEs' objectives are not that broad as with large organizations. Therefore, it is fair enough for them to have specific accounting standards that suits their size, capacities and abilities. Though it is that Ernst & Young, Sri Lanka 2012 says that user group needs; skills of SMEs; and cost benefits aspect have been the drivers behind the development of a specific standard for SMEs.

Main benefits that can be derived from SLFRS for SMEs can be seen in two forms. One set of benefits can be categorized as general benefits and second set of benefits can be categorized as specific benefits arising because of applying SLFRS for SMEs. However, following are the main benefits that the SME can derive from SLFRS for SMEs.

1. Applying SLFRS for SMEs is likely to be a useful stepping-stone for growing businesses considering a future listing.

2. It establishes more comparability between SMEs in similar size companies in the same sector, in Sri Lanka and in other countries that apply IFRS for SMEs.

3. It increases investor confidence especially among foreign investors investing in SME sector companies in Sri Lanka. Application of stand-alone accounting standards will enhance the

confidence of equity investors and lenders due to transparency and reliability of financial information. In other words, applying SLFRS for SMEs facilitate easier access to capital market.

4. SLFRS for SMEs is a shorter version of full SLFRS/LKAS. Therefore less complexity, less time and resources involvement, and it minimizes cost of application when compared to full version of SLFRS (Ex: Around 3,000 disclosure points in full SLFRS whereas it is only 300 disclosure points in SLFRS for SMEs)

5. It establishes confidence-approach to large entities in acquiring or investing in SMEs due to application of SLFRS for SMEs.

6. The flexibility of application has been recognized by SLFRS for SMEs in several circumstances. Such flexibility assists the SMEs to apply the accounting standards within the available resources while reducing the cost and saving time. For an instance, in some cases fair value has to be taken into account only if it can be measured without undue cost or effort to the management.

Conclusion

It is well recognized that the SME sector contributes immensely to economies. Policy makers of developed and developing countries are therefore interested in making their economic policies by giving due recognition to the SME sector companies in the economic development process. As a result, The Institute of Chartered Accountants of Sri Lanka has taken a step in line with the international accounting standards (IFRS) to implement the SLFRS for SMEs to support the development of SME sector in Sri Lanka.

Thus, it is very much evident that SLFRS for SMEs are of immense benefit to the SME sector in the country, facilitating its growth and thus contributing to the economic development of Sri Lanka.

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