

## What Influences the Implementation of IFRS for SMEs? The Brazilian Case

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# Goal & Motivation

- Investigate the factors that inhibit the implementation of IFRS for SMEs by firms of a large emerging economy, Brazil
- SMEs account for approximately 99% of global enterprises (OECD, 2017)
  - Generate around 70% of jobs
  - Responsible for 33% of the GDP in emerging economies (EEs)
- Literature on IFRS for SMEs is lacking in at least three avenues
  - Empirical studies on SME's users' needs (Devi and Samujh, 2015)
  - Challenges that have prevented implementation by SMEs (Zehri and Chouaibi, 2013; Rudzani and Charles, 2017)
  - EEs are misrepresented in the international setting (Devi and Samujh, 2015; Khlif, Ahmed and Alam, 2020)
- Several countries mandated implementation of IFRS for SMEs
  - Little evidence of the benefits of the implementation
  - It could have significant different implications in less developed economies

# Setting

- The accounting model for SMEs at the global level was arbitrary (Chand, Patel and White, 2015)
  - A decision was taken without proper evidence of their benefits
- Smaller business can be deeply affected by rules that are too complex (Kaya and Koch, 2015; Gassen, 2017; Poli, 2017)
- Practitioners had little participation on the standard for SMEs (Pietra et al., 2008; Quagli and Paoloni, 2012; Ghio and Verona, 2018)
- In Brazil, IFRS for SMEs has been adopted since 2010 (CPC PME)
  - Mandatory on paper, but:
    - Low enforcement (Brown, Preiato and Tarca, 2014; De Moura and Gupta, 2019)
    - Absence of sanctions
  - Cost of non-compliance is low: discretionary / voluntary
    - Adopters may have seen benefits > costs

# Contribution and Implication

- Investigating the difficulties and the inhibiting factors in a large emerging market setting.
- Research in emerging markets explores the different national institutional settings such as lower levels of enforcement of accounting standards and high corruption
- **Lack of training** of the standard is the **leading factor** for Brazilians not adopting IFRS for SMEs.
- The absence of sanctions is not an important factor behind non-implementation
- **IASB should work more closely with national regulators on implementing the standard effectively concerning training and disseminating the standard to current and future practitioners**

# Propositions

- Complexity of IFRS for SMEs is intrinsic to its structure
  - Same scope and application of the full IFRS standard, which can be overly complicated (Bar-Yosef, D'Augusta and Prencipe, 2019)
  - Some of the standard's requirements demand guidance and illustrative examples (Salazar-Barquero, 2011)
  - **P1: structural and practical issues of the IFRS for SMEs inhibit its implementation in Brazil.**
- SMEs more focused on tax compliance, may not see other benefits from SMEs standard (Alves et al., 2013; Asuman, 2010; Bohusova, 2011; Pietra et al., 2008)
  - Advantages of implementing IFRS for SMEs are generally considered less convincing and the perceived costs greater than its benefits (Pietra et al., 2008)
  - General idea that the standard's implementation can only be successful with ample enforcement (Kaya and Koch, 2015; Gassen, 2017)
  - **P2: the absence of sanctions for non-compliance with the mandatory implementation of the IFRS for SMEs inhibits its implementation.**

# Method

- Questionnaire with two sections
  - Section A with nine questions
    - Q1a-Q3a measure the respondent's level of knowledge regarding the IFRS for SMEs standard and whether the respondent works with SMEs
      - If a respondent reported not having at least a basic knowledge of IFRS for SMEs, or outside the SMEs context, we exclude s/he from the analyses
    - Q4a-Q6a position within the organization, geographic location, and level of education in accountancy)
    - Q7a asks whether the organization has implemented IFRS for SMEs
    - Q8a asks whether the company has an internal accounting department
    - Q9a asks whether the respondent took any accounting course in the previous year
  - Section B basically the questionnaire of Chand et al. (2015)
    - Drop question 23, regarding tax benefits: not applicable according to IFRS in Brazil (Comitê de Pronunciamentos Contábeis, 2009)
    - Add question regarding the absence of sanctions (Q23b), consistent with hypothesis H2

# Method

- A professional translator converted the original questions to Brazilian Portuguese
  - A second professional translator switched the translated Brazilian Portuguese version back to English
  - We compare this re-translated version with the original (reverse translation)
    - Assess that it maintains the original meaning.
- Sample and model
  - Hand collected list of users from the Brazilian Federal Council of Accountants (CFC)
    - Accountants + accounting firms from all over the country
    - Sent a link to the questionnaire via email, WhatsApp messaging and LinkedIn professional network.
      - Leverage the distribution using the snowball method
  - 426 valid responses from accountants, directors, and other senior staff involved in the process of financial reporting according to IFRS for SMEs
  - Model of the determinants of IFRS for SMEs non-implementation (logit regression)
  - $Prob(NotImplementIFRSSME = 1) = \beta_0 + \beta_1 Costs + \beta_2 Inconsistencies + \beta_3 Inaccuracies + \beta_4 Comprehensibility + \beta_5 Guidance + \beta_6 Complexity + \beta_7 Sanctions + \beta_8 OnPremises + \beta_9 Training + u$

# Results – Sample

- We validate 426 observations from 825 respondents.
- Balanced Sample across five regions of Brazil compared to the registry from Federal Council of Accountants of Brazil
- Good variation within Knowledge and Positions
- Although is a Convenience Sample, it seems a good representation of Brazil
- 384 respondents give 95% confidence level with  $\pm 5\%$  margin of error

Table 2: Participants' characteristics

| Panel A: Implementation and training                                |                |  |     |  |     |
|---|----------------|--|-----|--|-----|
| The company/office where he/she works has implemented IFRS for SMEs |                | He/she works in a company with internal accounting or third-party accounting |     | Respondent takes annual training courses |     |
| Yes   | 263            | Internal   | 195 | Yes                                      | 359 |
| No  | 163            | Third-party  | 231 | No                                       | 67  |
| Total   | 426            | Total  | 426 | Total                                    | 426 |
| Panel B: Level of knowledge   |                |  |     |  |     |
| Level of knowledge of IFRS for SMEs                                 |                | Accounting Training  |     | Position                                 |     |
| Basic   | 181            | Technical  | 36  | Analyst                                  | 25  |
| Intermediate  | 159            | Incomplete Higher Education  | 13  | Accountant                               | 210 |
| Advanced  | 86             | Complete Higher Education  | 377 | Manager                                  | 27  |
|   |                |  |     | Controller                               | 19  |
|   |                |  |     | Director                                 | 14  |
|   |                |  |     | Partner / Owner                          | 131 |
| Total   | 426            | Total  | 426 | Total                                    | 426 |
| Panel C: Geographical distribution                                  |                |  |     |  |     |
| Region  | % participants | % Brazil   |     |  |     |
| Midwest   | 13.4           | 8.5  |     |  |     |
| Northeast   | 18.5           | 16.1   |     |  |     |
| North   | 7.7            | 6.0  |     |  |     |
| Southeast   | 44.6           | 51.6   |     |  |     |
| South   | 15.7           | 17.8   |     |  |     |
| Total (count)   | 100 (N=426)    | 100 (N=515,262)  |     |  |     |

# Results

- Column 1 – All
- It seems Inconsistencies and incomprehensibility drive non-impl.
- Inaccuracies and Lack of Guidance seems to boost adoption (Conversely)
- Columns 2 and 3 tell a different story
- Column 1 results are only valid for Non. Managerial
- Incomprehensibility of IFRS is related to the level of knowledge
- Higher Training boost implementation

Table 6: IFRS non-implementation and not advanced knowledge

|                       | (1)                   | (2)                  | (3)                  | (4)                  | (5)                   |
|-----------------------|-----------------------|----------------------|----------------------|----------------------|-----------------------|
|                       | Non-impl. all         | Non-impl. non-manag. | Non-impl. managerial | Knowledge Not Adv.   | Knowledge level       |
| Costs                 | 0.020<br>(0.155)      | -0.060<br>(-0.310)   | 0.097<br>(0.496)     | 0.177<br>(1.011)     | 0.115<br>(0.911)      |
| Inconsistencies       | 0.488***<br>(2.953)   | 0.523**<br>(2.319)   | 0.400<br>(1.359)     | -0.280<br>(-1.165)   | -0.016<br>(-0.099)    |
| Inaccuracies          | -0.388**<br>(-2.526)  | -0.460**<br>(-2.200) | -0.283<br>(-1.255)   | -0.231<br>(-1.022)   | -0.177<br>(-1.125)    |
| Incomprehensibility   | 0.369*<br>(1.736)     | 0.457*<br>(1.714)    | 0.236<br>(0.625)     | 1.015***<br>(3.239)  | 0.545**<br>(2.417)    |
| Lack Guidance         | -0.294**<br>(-1.990)  | -0.371*<br>(-1.747)  | -0.164<br>(-0.809)   | -0.093<br>(-0.514)   | 0.001<br>(0.008)      |
| Complexity            | 0.073<br>(0.391)      | 0.228<br>(0.907)     | -0.104<br>(-0.376)   | -0.036<br>(-0.146)   | -0.156<br>(-0.896)    |
| Sanctions             | -0.013<br>(-0.231)    | -0.009<br>(-0.096)   | -0.030<br>(-0.353)   | -0.085<br>(-1.107)   | -0.047<br>(-0.891)    |
| <u>OnPremises</u>     | 0.292<br>(1.365)      | 0.326<br>(1.153)     | 0.366<br>(1.080)     | 0.270<br>(1.023)     | 0.071<br>(0.372)      |
| Training              | -0.767***<br>(-2.696) | -0.623*<br>(-1.691)  | -1.122**<br>(-2.289) | -1.216**<br>(-2.374) | -1.141***<br>(-3.963) |
| Constant              | -0.754<br>(-1.454)    | -0.987<br>(-1.443)   | -0.284<br>(-0.323)   | 0.726<br>(0.949)     |                       |
| Cut1                  |                       |                      |                      |                      | -1.478***<br>(-2.880) |
| Cut2                  |                       |                      |                      |                      | 0.356<br>(0.709)      |
| Pseudo R <sup>2</sup> | 0.088                 | 0.092                | 0.086                | 0.127                | 0.056                 |
| Observations          | 426                   | 235                  | 191                  | 426                  | 426                   |

# Results – role of knowledge

Table 7: Determinants of IFRS non-implementation: Knowledge

| Variables                     | (1)<br>Logit          | (2)<br>AME            |
|-------------------------------|-----------------------|-----------------------|
| Intermediate knowledge        | -1.737***<br>(-7.170) | -0.321***<br>(-9.858) |
| Advanced knowledge            | -2.726***<br>(-7.075) | -0.503***<br>(-8.916) |
| Constant                      | 0.579***<br>(3.734)   |                       |
| Pseudo $R^2$                  | 0.173                 |                       |
| AIC                           | 474.9                 |                       |
| $H_0$ : Intermediate=Advanced | 0.013                 |                       |
| Observations                  | 426                   | 426                   |

Notes: z statistic in parentheses. \*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ . Column (1), Logit, displays the coefficients from the regression of Equation (3)  $Prob(NotImplementIFRSSME = 1) = \beta_0 + \beta_1 IntermedKnow + \beta_2 AdvKnow + u$ , while column (2), AME, are the Average Marginal Effects of the Logit model.  $H_0$ : Intermediate=Advanced is the p-value of the test  $H_0$ : the indicated variables' coefficients are equal.

# Extra – Interviews (Not yet in the paper)

- We interviewed two senior accountants / audit partners who provide training, consulting, and audit services to SMEs as an additional cross-check.
- This data triangulation provides deeper insights on our findings and greater assurance about the results.
- Semi-structured interview

# Extra – Interviews (Not yet in the paper)

- Many of the issues related to incomprehensibility seem related to the need for judgement and discretion.
  - Managers are better able to understand how to make a judgement to represent the economical essence of transactions;
  - Non-managers such as accountancy analysts are used to following strict rules with no need to make subjective decisions. Many only perform tax accounting;
  - Terms that reflect the need for judgement and discretion, like “maximum extent possible”, “reliable measurement”, “highly probable”, and “significant risks”, cause more confusion among accountants;
  - Parts of the standard that can be more difficult to understand refer to items that are rarely used by smaller firms, such as financial instruments, derivatives, currency translation, fair value, and related terminology, such as “debt instrument”, “hedge”, and “swap”.

# Extra – Interviews (Not yet in the paper)

- Regarding training, many firms do not see it as necessary. Many times, managers refuse to pay for the training of the firm's accounting staff. Often, staff pay for courses out of their own pockets.
  - There is a generalised problem with accountants' training in Brazil. They still receive training to follow strict rules and pre-defined tables, not making judgements and decisions. One famous rule of thumb is allocating 3% of accounts receivable as doubtful debts, regardless of the risk profiles of different customers.
  - Accounting bodies, like the State Accounting Councils (CRCs) and the Federal Accounting Council (CFC), usually do not offer IFRS for SMEs courses.
  - Although most firms are SMEs, IFRS for SMEs training in higher education is deficient or non-existent.
  - Accountants, especially the older ones, do not have training in concepts such as present value and discount rates.

# Extra – Interviews (Not yet in the paper)

- After knowing the standard or having implemented it, implementers start seeing its benefits.
  - Access to cheaper loans.
  - Statements adequately audited by a chartered auditor registered with the Brazilian Securities Commission (CVM) and the Brazilian Institute of Independent Auditors (IBRACON).
- The main findings
  - Support our view that lack of knowledge about the standard is a major issue regarding non-implementation.
  - IFRS for SMEs standard has a level of detail and complexity adequate for SMEs.
  - The most complex parts often are only applicable to larger firms, which are also naturally more complex.

# Conclusion

- Main result
  - $\uparrow$  Knowledge:  $\downarrow$  Prob(non-implementation)
- Better understanding of how accounting professionals perceive IFRS for SMEs
- Perceptions from practitioners from a large Latin American market, Brazil
- IASB should weigh in strategies to promote courses with local regulators

# Thank you!

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# Backup slides

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# Variable definitions

| Type                     | Variable from Equation (1) | Description   | Source                        |
|--------------------------|----------------------------|---|-------------------------------|
| Dependent                | <i>NotImplementIFRS</i>    | IFRS for SMEs implementation dummy. Set to one (1) if it has not implemented IFRS for SMEs and zero (0) if it has implemented. Q7a of the questionnaire (see Appendix A).   |                               |
| Independents of interest | <i>Costs</i>               | Arithmetic mean of the responses (1-7 Likert-like scale) to questions Q1b, Q7b and Q9b.   | Chand, Patel and White (2015) |
|                          | <i>Inconsistencies</i>     | Arithmetic mean of the responses (1-7 Likert-like scale) to questions Q14b, Q15b, Q17b, Q25b and Q27b.  |                               |
|                          | <i>Inaccuracies</i>        | Arithmetic mean of the responses (1-7 Likert-like scale) to questions Q4b and Q11b.   |                               |
|                          | <i>Comprehensibility</i>   | Arithmetic mean of the responses (1-7 Likert-like scale) to questions Q3b, Q5b, Q12b, Q13b, Q16b, Q18b, Q24b and Q26b of the questionnaire.   |                               |
|                          | <i>Guidance</i>            | Arithmetic mean of the responses (1-7 Likert-like scale) to questions Q20b, Q21b, Q28b, Q29b and Q30b of the questionnaire.   |                               |
|                          | <i>Complexity</i>          | Arithmetic mean of the responses (1-7 Likert-like scale) to questions Q2b, Q6b, Q8b, Q10b, Q19b and Q22b of the questionnaire.  |                               |
|                          | <i>Sanctions</i>           | The response (1-7 Likert-like scale) to question Q23b.  | Albu <i>et al.</i> (2013)     |
| Independents – controls  | <i>OnPremises</i>          | Q8a. OnPremises is 1 if the respondent reports having internal accounting and 0 for outsourced, third-party accounting. Asuman (2010) found evidence that if the company has an accounting department, then the additional cost of applying another set of accounting standards may be reduced. Therefore, national SMEs with an internal accounting department, which is uncommon, are more likely to implement the standards. | Asuman, (2010)                |
|                          | <i>Training</i>            | Q9a. Training is 1 if the respondent reports having taken accounting courses the previous year. Chand et al. (2015) state that a difficulty for accounting professionals in dealing with <i>IFRS for SMEs</i> is due to the lack of training and adequate and continued development. Therefore, the decision of an accounting professional to be trained may affect the likelihood of implementing the standard.                | Chand, Patel and White (2015) |

# Comparison with Chand et al. (2015) results

| Variables |  | Current paper |      | Chand et al. (2015) |      | Variables |  | Current paper |      | Chand et al. (2015) |      |
|-----------|--|---------------|------|---------------------|------|-----------|--|---------------|------|---------------------|------|
|           |  | Mean          | SD   | Mean                | SD   |           |  | Mean          | SD   | Mean                | SD   |
| Q1b       | The costs of complying with the IFRS for SMEs are far greater than the corresponding benefits                              | 4.28          | 1.69 | 4.18                | 1.42 | Q19b      | IFRS for SMEs is too complex for SMEs in Brazil  | 4.42          | 1.85 | 4.64                | 1.62 |
| Q2b       | Extensive cross-referencing to full IFRS is required while interpreting and applying IFRS for SMEs                         | 5.22          | 1.55 | 4.46                | 1.39 | Q20b      | IFRS for SMEs do not provide adequate guidance to assist accountants in interpreting and applying this standard  | 4.06          | 1.80 | 3.90                | 1.48 |
| Q3b       | IFRS for SMEs in general are not easy to understand  | 3.99          | 1.71 | 3.87                | 1.55 | Q21b      | IFRS for SMEs do not provide adequate guidance to address the social and economic characteristics of SMEs in Brazil  | 4.13          | 1.80 | 4.17                | 1.43 |
| Q4b       | IFRS for SMEs contain expressions that are lacking clarity   | 3.88          | 1.73 | 4.21                | 1.43 | Q22b      | There is a need to create an additional tier of differential reporting framework in Brazil for really small (micro) entities   | 4.62          | 1.79 | 4.78                | 1.90 |
| Q5b       | The vocabulary used in IFRS for SMEs is difficult to understand  | 3.78          | 1.72 | 3.38                | 1.35 | Q23b      | The non-implementation of IFRS for SMEs is due to the absence of sanctions and penalties by regulatory bodies, which discourages professionals from adhering to an activity that generates burdens | 4.07          | 1.98 | -                   | -    |
| Q6b       | The nature, volume and complexity of disclosure required by IFRS for SMEs is excessive                                     | 4.26          | 1.82 | 4.20                | 1.61 | Q24b      | There are transactions, events or conditions that SMEs engage in that are not covered in IFRS for SMEs   | 4.19          | 1.66 | 3.66                | 1.36 |
| Q7b       | The information required to apply IFRS for SMEs is not available or available with only undue cost or effort               | 3.83          | 1.72 | 4.22                | 1.45 | Q25b      | Certain terms are not defined in the same way across IFRS for SMEs   | 3.72          | 1.62 | 3.58                | 1.36 |
| Q8b       | The use of fair value accounting (FVA) is excessive in IFRS for SMEs   | 4.23          | 1.77 | 4.40                | 1.52 | Q26b      | It is difficult to capture the meaning of some terms in IFRS for SMEs  | 3.83          | 1.71 | 3.62                | 1.40 |
| Q9b       | The use of FVA in IFRS for SMEs imposes significant annual costs on preparers and is not justified on cost/benefit grounds | 4.40          | 1.77 | 4.54                | 1.56 | Q27b      | Some terms in IFRS for SMEs are used inconsistently  | 3.57          | 1.67 | 3.38                | 1.37 |
| Q10b      | The need to exercise professional judgement is excessive in IFRS for SMEs  | 4.23          | 1.66 | 4.64                | 1.48 | Q28b      | How often do you need to consult with other resources, such as manuals provided by employers, consultation with senior staff, etc., when applying IFRS for SMEs?                                   | 4.48          | 1.76 | 4.63                | 1.75 |
| Q11b      | Individual paragraphs within IFRS for SMEs are repetitive  | 3.84          | 1.56 | 3.88                | 1.23 | Q29b      | Do you think different professional accountants will always reach the same judgement on a specific scenario under the guidance of IFRS for SMEs?   | 4.27          | 1.79 | 3.46                | 1.54 |
| Q12b      | The paragraph coding in IFRS for SMEs is confusing   | 4.11          | 1.72 | 3.79                | 1.26 | Q30b      | Have you ever been in disagreement with your colleagues when deciding which alternative treatment given by IFRS for SMEs is the most appropriate to employ in a particular scenario?               | 4.25          | 1.72 | 3.71                | 1.64 |
| Q13       | IFRS for SMEs are structured in a way that is difficult to follow  | 3.79          | 1.62 | 3.61                | 1.39 |           |  |               |      |                     |      |
| Q14b      | Recognition criteria applied in IFRS for SMEs are not easy to understand   | 3.35          | 1.62 | 3.92                | 1.44 |           |  |               |      |                     |      |
| Q15b      | Measurement criteria are not applied consistently across IFRS for SMEs   | 3.40          | 1.60 | 3.99                | 1.33 |           |  |               |      |                     |      |
| Q16b      | Recognition criteria applied in IFRS for SMEs are not easy to understand   | 3.51          | 1.57 | 4.03                | 1.33 |           |  |               |      |                     |      |
| Q17b      | Criteria employed in allowing alternative accounting treatments are not applied consistently across IFRS for SMEs          | 3.50          | 1.62 | 4.04                | 1.29 |           |  |               |      |                     |      |
| Q18b      | The alternative treatments given in IFRS for SMEs are not easy to understand   | 3.57          | 1.63 | 4.01                | 1.27 |           |  |               |      |                     |      |

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