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# Financial reporting of micro and small enterprises (MSE)

in transition economies  
of Central and Eastern Europe

Polskie Wydawnictwo Ekonomiczne

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Polskie Wydawnictwo Ekonomiczne

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## Introduction

The transformations the countries of Central and Eastern Europe (CEE) have undergone, initiated at the turn of the 1980s and 1990s, are examples of the most spectacular political, social and economic changes. The economies of these countries are still under transformation, *i.e.* the scope to which they have been taking advantage of the laws of the market is systematically increasing. This provokes a number of deep and rapid changes in the economic environment, which are reinforced by the liberalization of the flow of capital, goods and services as well as the workforce, on the global scale. One of the effects of these changes is the growing significance of the micro and small enterprise (MSE) sector for the economic development of the countries with different levels of development and different political, social and cultural structure. In the European Union, there are over 24 million enterprises in this sector, which employs over 73 million persons out of the total number of professionally active people. Micro and small enterprises play a special role in the economy, due to both their impact on the development of entrepreneurship and the ability to quickly adapt to changing economic conditions. The role and the great importance of MSEs in the economy have been emphasized in scientific publications and economic reports.

One of the key problems enterprises of the MSE sector are currently facing is its accelerating development. Acceleration of economic development is not possible without investors' and creditors' confidence in the financial information generated by MSE financial reporting. Stakeholders expect accurate information, not only about a given company's operations and financial activities, but also about the impact this has on the environment. Comprehensive information constitutes the basis for success, because when obtained at the right moment, it enables to gain competitive advantage and limits the economic and investment risk on the market. Consequently, a growing number of enterprises are obliged to prepare increasingly complex reports and disclose more and more information. A company that strives to survive on the market must base its business on many right decisions. Undoubtedly, the decision-making process depends, to a large extent, on access to reliable information about the property and financial standing of a given entity. Financial reporting of the

MSE sector, which constitutes the basis for assessment, both in retrospective and prospective terms, provides the source of such information.

However, this sector has not been properly diagnosed yet. As a consequence, programs are not really adapted to the results sought. The study attempts to address three research problems:

1. What is the status and significance of the MSE-sector enterprises in selected CEE countries?
2. Which reporting obligations do enterprises from the MSE sector have?
3. Which potential and which right direction exist for improvement in terms of MSE-sector reporting in the CEE countries in perspective of sustainable development?

This monograph aims to conduct a cross-country comparative analysis of the financial reporting requirements of micro and small enterprises a few years after the introduction of Directive 2013/34/EU. It assesses the reporting requirements of micro and small enterprises in 9 Central and Eastern European countries that have undergone systemic transformations. Since these countries are diverse in terms of the geographical, historical, systemic and political factors that affect them, and the economic policy directions adopted after the changes, they have been divided into two groups:

1. European Union Member States – Croatia, Lithuania, Latvia, Poland, Romania, Slovenia;
2. countries that are not members of the European Union – Belarus, Moldova, and Ukraine.

The study consists of 11 chapters, divided into three parts. The content of individual parts is related to:

1. The socio-economic environment of the MSE sector in selected countries of Central and Eastern Europe (CEE) and the financial reporting in the global economy (chapters 1 and 2).
2. The financial reporting of micro and small enterprises in selected CEE countries – Belarus, Croatia, Latvia, Lithuania, Moldova, Romania, Poland, Slovenia, Ukraine (chapters 3–11).
3. A comparative analysis of the reporting requirements of micro and small enterprises surveyed (Summary).

Due to the role the MSE-sector enterprises play in the global economy, the research and analysis conclusion indicates recommendations regarding the harmonization of the reporting requirements for the enterprises of the MSE sector in the CEE countries that have undergone systemic transformations.

In the opinion of the Authors of the monograph, the benefits of the MSE-sector reporting harmonization go beyond comparability. Unification of regulations brings benefits for the entire international business environment. It facilitates assessment and comparison of the financial situation of enterprises and thus streamlines the process of investment decision making. By providing comparable financial statements, enterprises secure wider access to capital.

It should be added that a large group of MSEs in the countries under examination keep the records required by the provisions of national tax law, which significantly limits the possibility of assessing their financial and property condition and thus limits their access to foreign capital. To enable the owners of these enterprises to properly assess the economic condition of their businesses, it would be necessary to expand the mandatory tax records by including information on the value of inventories, receivables, broken down into past due and not past due receivables, the state of indebtedness (liabilities to suppliers, bank loans, other liabilities), as well as cash.

As such, the following postulates can be formulated in the pursuit of harmonization of financial reporting of the MSE sector:

1. It is a heterogeneous group of enterprises, in the light of the quantitative features of their qualification (employment, turnover, balance sheet total). This results in different information needs.
2. MSEs can be entities with either national or transnational scope of activities.
3. MSEs are entities of various organizational and legal forms (natural persons, partnerships, capital companies, international enterprises).
4. MSEs are entities at various levels of development (life cycle).
5. MSEs are entities that often are not capital market participants.

When developing MSE-sector reporting information, however, it should be borne in mind that:

- The quality of the information generated by MSEs largely depends on who it is addressed to. The primary group of MSEs' financial information recipients includes: owners, employees, creditors and lenders, leasing companies and tax offices.
- They are usually identified recipients, not anonymous ones, dispersed as in the case of large enterprises.
- The structure of the stakeholder group interested in the information generated by MSE companies depends on the stage of these enterprises' development (life cycle).
- Information on financial management of MSE-sector enterprises can be used in various orientation. Most often it is related to tax burdens, incentive systems, control of receivables, liabilities, cash and inventory.
- The use of capital-market instruments for financing business activities is often limited or none at all.

- Many micro and small enterprises do not employ properly qualified staff. Often, highly qualified specialists are not interested in working in small enterprises, seeing no opportunities for development and further career.
- These enterprises have limited financial resources.

Improvement of the MSE-sector reporting should therefore move towards coordination of the accounting regulations regarding the principles, the layout and the content of annual financial statements and the methods of valuing the items in the reports.

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