

Accounting and Financial Reporting for SME and Micro Enterprises in Albania

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Abstract

Recent progress and regional integration of the Albanian economy have presented a lot of challenges for the SME-s and the micro enterprises in Albania. One of the challenges, namely the regulation of the financial reporting framework for SME-s and micro entities becomes the focus of this study and we discuss on the problems that the micro enterprises faced when required to comply with the new accounting regulations. We find that these entities experience increased costs of reporting and lacked the proper experience to successfully handle the transition toward the new accounting regime. For ensuring a correct implementation of the new accounting rules and for increasing the awareness of the micro enterprises about the importance of qualitative financial information a close cooperation among the involved parties is needed. We recommend that the academic institutions, the professional organizations and the accounting regulatory bodies in Albania undertake trainings in order to enhance the knowledge on the new accounting rules.

Keywords: SME, accounting standard, financial reporting.

JEL Classification: M41

1. Introduction

A clear determination and classification of the micro enterprises in Albania has taken place only recently, despite the twenty years old history of free market economy in this country. Unlike many other countries of the Central and Eastern Europe which were characterized by a stable development of the private sector well before the 90s, in Albania any kind of private possession or activity was prohibited by law. The collapse of the centralized economic system in early 90s opened the doors to free market economy for

Albania. In this particular period the small and medium enterprises in Albania experienced huge growth mainly because of the private investments made by the Albanian citizens and the many opportunities that the new Albanian market offered in the early 90s. During the twenty years of economic transition history the small and medium enterprises as well as the microenterprises have played a decisive role in economic development, thus being important actors in Albanian economic system.

As such, their performance has always been important and the focus of different economic measures (and other measures) undertaken by Albanian government. In this respect the quality of their internal accounting regulation is important for their growth and development. This is why recently, along with the enhancement of accounting and financial reporting legal framework for big business in Albania, in 2009 the accounting regime for the micro entities and the SME-s also changed. Since 2006 Albania has its own local National Accounting Standards (NAS) which are written in accordance with the full IFRS/IAS and are mandatory for enterprises which operate domestically.

To extend the scope of NAS in 2009 another standard (no 15) was prepared which aimed to regulate the accounting and financial reporting rules for the micro enterprises in Albania. This new NAS no 15 was expected to contribute towards decrease of the shadow economy (mainly observed among micro enterprises) as well as to increase the information quality in these entities. There have already been two years since the micro enterprises are required to comply to the new NAS no 15 so it is time to analyze its effects. This paper focuses on the micro and SME-s performance and their importance for Albania as well as on the difficulties and challenges that the new accounting regulation has introduced for them. We aim to give several topics that the business community has identified as problematic and troublesome during the implementation of the new NAS. Also, based on these issues we try to offer possible solutions for each party involved in the implementation process.

This paper is organized as follows. In the first part we present an overview of the SME-s and the micro enterprises in Albania, their legal and institutional framework as well as their performance in the recent years. Next we address the issue of accounting and financial regulation for this sector,

focusing specifically on the event of NAS no 15 endorsement and its impact on the micro entities and SME-s information quality. Finally we conclude the paper by summarizing the main findings.

2. SME and micro enterprises in Albania

Many entrepreneurs in Albania have started their business during the transition period where there was “nothing to lose” and possibly a lot to win. The majority of these new entrepreneurs that were penetrating the market had not the adequate education for business, not even the slightest experience managing an enterprise, and often very limited capital to invest, but they learned to walk hand in hand with market growth and several of them made it not only to overcome the initial barriers but eventually to be transformed in important big business in Albania (Çepani, 2006). In the beginning the Albanian market was characterized by many growth opportunities, quite few barriers to enter the market and low competition which in turn created an appropriate environment for the first enterprises.

However, despite of the success these businesses experienced in the first years, the financial and economic crisis of 1997 demonstrated how fragile this progress was and the many hidden limitations for the SME-s and the micro enterprises. It was during this time that many SME went bankrupt and many other micro enterprises were closed. Nevertheless, even after the riots of ‘97 the remaining SME-s continued to play an important role in the domestic economy and in a way they contributed to help the Albanian economy to overcome the crises and return to normality. Although the most part of SME-s used to operate (and some still do) under informality, they enabled free movement of capital and cash flow and thus helped the domestic economy to move forward. These businesses now comprise the vast majority of private businesses operating in Albania and because of their size and ability to adapt to the market; they are the main source of employment and new marketing ideas.

2.1 Legal and infrastructural framework of SME in Albania

Even though the small, medium and micro enterprises were the first economic entities to develop in Albania right after the early 90s opening of

the domestic economy, they were not specifically defined or regulated in the Albanian legal framework until the early 2000s. The first law, prepared and approved specifically for the small and medium enterprises was the law no 8957, dated 17.10.2002 “For small and medium enterprises”, changed with the law no 10042, dated 22.12.2008.

Law no. 8957 dated 17.10.2002, “For small and medium enterprises”, was prepared in accordance with articles 78, 81 paragraph 1 and 83 paragraph 1 of the Constitution of Republic of Albania, and is the first law aiming to regulate and classify the SME-s as well as to promote their development in the future. The purpose of this law was to help small, medium and micro enterprises through the establishment of an institutional, regulatory and financial framework. For the first time this law clearly defined the terminology in relation to SME-s and their classification. The SME-s classification changed subsequently in law no. 10042 dated 22.12.2008, to redefine and categorize the entities in micro, small and medium enterprises according intervals which were closer to the categorization of the SME-s in the European Union legal framework. Therefore, the enterprises in Albania are currently grouped according the following categories.

- Micro enterprises are those entities employing from 1 to 9 employees and having annual balance sheet total assets or annual turnover up to 10 million ALL (approx. 70.000 EUR). Within this group a further categorization with 0-1 employees and 2-9 employees is usually applied.
- Small enterprises are those entities that employ from 10 to 49 employees and have annual balance sheet total assets or annual turnover up to 50 million ALL (approx. 350.000 EUR).
- Medium enterprises are those entities that employ 50-249 employees.

The development of SME-s and their contribution to long-term economic stability depends on their size and structure, which in well-developed markets allow them to have the required flexibility and ability to adapt to conditions of severe competition. Competitiveness of SME-s has a

huge impact on the competitive position of the economy as a whole. High transaction costs are one of the major barriers to their development and their reduction would encourage the expansion of SME-s, and especially of micro-enterprises. The Ministry of Trade, Economy and Energy of Albania has clearly defined in its strategy for the business development and investments during 2007-2013, the following priorities concerning the development of SME-s:

- Harmonization with policies for each sector.
- Creating adequate conditions for fair competition and supporting the SME-s in their integration in the regional market.
- Developing information technology and entrepreneurship culture.
- Ensuring transparency of the decisions, actions and measures which influence the business environment of the SME-s.

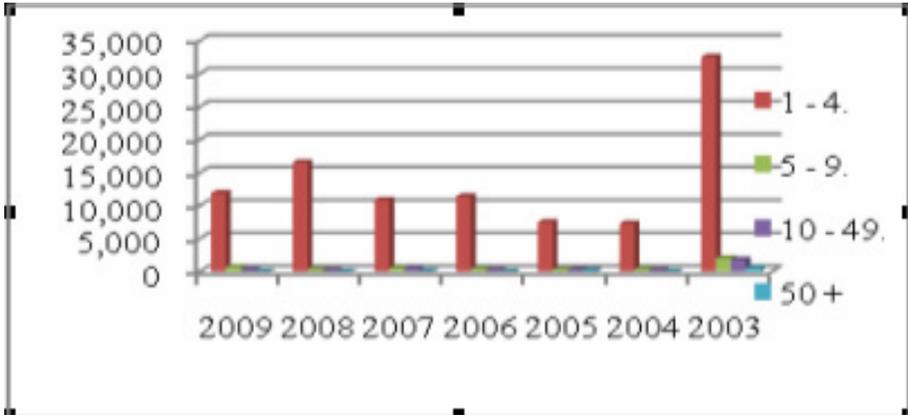
The above listed development policies of the SME-s in Albania for the period 2007-2013 are defined in full consistency with all the acts of the Stabilization and Association Agreement that Albania has signed with the European Union. They have also taken in consideration the European Card for the small and medium enterprises. In this context, the development and performance of SME-s and especially micro enterprises would be a real challenge during the integration of the Albanian economy in the European Union common market.

2.2 Development and performance of the SME-s in Albania

The number of active enterprises in Albania during the period 2003 – 2009 is varying depending on the cycles of economy. It experienced a sudden and drastic decrease in 2004 when the domestic crises in Albania forced many enterprises to close. Then the number of micro and SME-s increased steadily with a slight decrease in 2007 and another one in 2009 when the effects of the global economic crises began to hit Albania (Bahiti, Shkurti & Babasuli, 2011). As seen in chart 1 below based on data of INSTAT (Institute of Statistics of Albania), at the end of 2009 about 91.95% of the entities are micro enterprises with 1-4 employees, while micro-enterprises with 5-9 employees represent about 4.26%, small enterprises with 10-49 employees to occupy only 3.04%

of the total and only 0.75% of enterprises have over 50 employees, thus being medium enterprises.

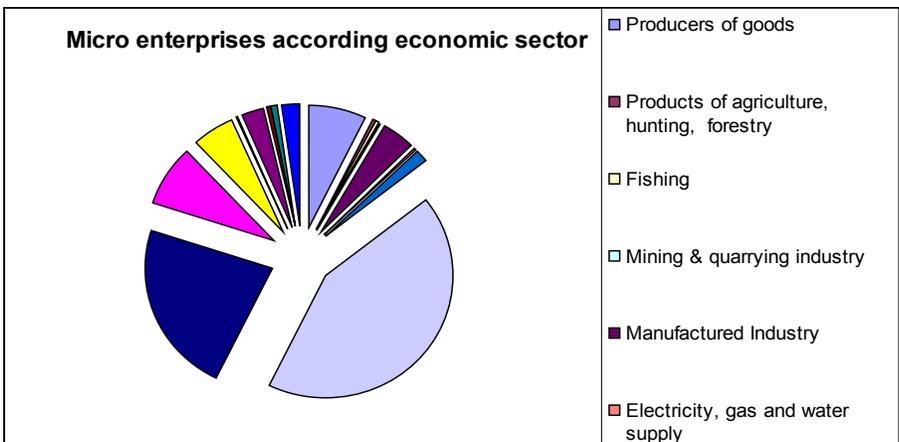
Chart 1. Trend of number of micro, small and medium enterprises.



Source: INSTAT 2010

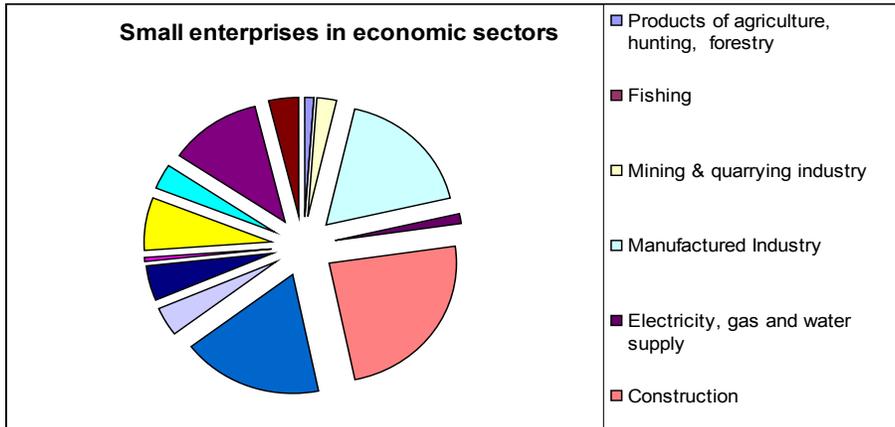
The micro, small and medium enterprises operate in virtually every sector of the Albanian economy. Among them, the service sectors, retail and wholesale have a higher percentage compared to the manufacturing sector. The charts 2, 3 and 4 below show the number of micro, small and medium enterprises for every sector of Albanian economy.

Chart 2. Micro enterprises' distribution in economic sector in Albania, year 2011.



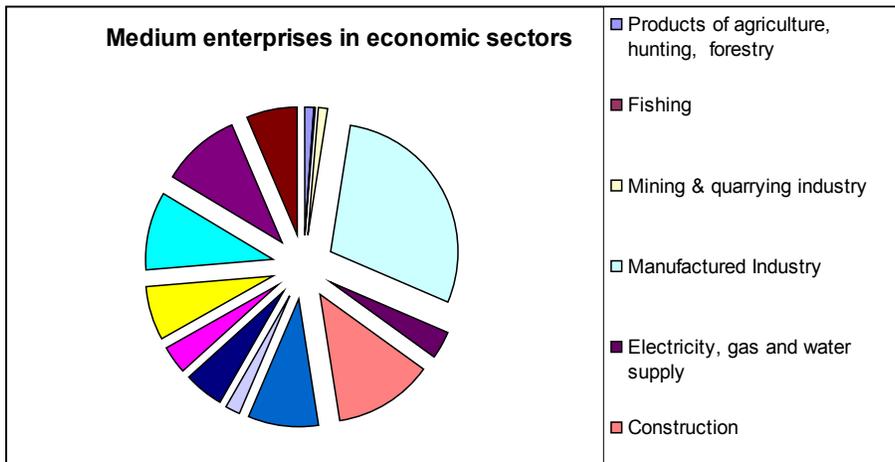
Source: INSTAT.

Chart 3. Small enterprises' distribution in economic sector in Albania, year 2011.



Source: INSTAT.

Chart 4. Medium enterprises' distribution per every economic sector in Albania, year 2011.



Source: INSTAT.

We can see from the above charts (chart 1) that micro enterprises consistently (from 2003 to 2009) represent the greater part of number of total business in each year. Moreover chart no 2 shows that they (the micro enterprises) are mainly focused in the trade sector. Small enterprises are concentrated mainly in the services sector, while industry and construction sectors are dominated by medium sized businesses. In these sectors the micro,

small and medium enterprises contribute extensively in the generation of economic growth, employment and poverty reduction.

3. Financial reporting standards for SME-s and micro enterprises

The recent economic and social developments in Albania, along with the increase in complexity of international financial reporting and auditing standards, the Albanian Government commitment to sign the Association and Stabilization Agreement, revealed the inadequacy of the domestic financial and accounting framework. These were among the reasons why in 2004 the Government of Albania undertook several deep reforms in the field of accounting. So, the National Accounting Council took the initiative to draft the new Law no. 9228 “On Accounting and Financial Statements,” which was endorsed by the Parliament on 29.04.2004. The new law “On Accounting and Financial Statements,” addresses many of the shortcomings of previous accounting and financial reporting requirements. Prior to 2004 the accounting requirements and the General Accounting Plan did not provide high quality financial reporting information, especially for the public interest entities, thus prohibiting the potential users of the information to take economic decisions (Shkurti & Gjoni 2010).

The new law no. 9228 defined the prerequisites for the foundation of the National Accounting Council of Albania (NACA) which would be the most important body governing the accounting and financial reporting environment in Albania. The NACA was designed to be a professional, public and independent body in charge of drafting the local National Accounting Standards (NAS). Its main objectives are:

- a) Continuous improvement of the legislation on accounting.
- b) Designing an accounting system in accordance with the Law on accounting no 9228.
- c) Development of National Accounting Standards in accordance with the IFRS/IAS.
- d) Promoting the implementation of the NAS and the International Financial Reporting Standards.

In order to accomplish its target the NACA with the support of the Government, through a project funded by World Bank and assisted by ‘Price Water House Coopers’ in 2005 – 2006 prepared a set of 14 national accounting standards, which are designed in full accordance with international standards. The NAS would be implemented by all public and private economic entities for accounting years starting in January 1, 2008, except for those big companies, which are required to endorse full IFRS/IAS. The correct implementation of the national accounting standards was expected to bring a significant improvement of the overall quality of financial information by entities in the public and private sector what in turn would improve the decision making process, increase the efficiency of management and transparency and reduce the country’s economic informality.

In contrast to many other countries which have either adopted international accounting standards for all entities, or have chosen to apply the IFRS/IAS for public interest entities while continuing with the existing national accounting regimes (occasionally with adjustments) for other entities, in Albania it was decided that two types of standards would be used (law no. 9228 dated 29.04.2004 “On Accounting and Financial Statements”): 1) international accounting standards; 2) national accounting standards.

The international accounting standards are required to be used by:

1. Companies listed in any official stock exchange market altogether with their subsidiaries which are subject to the consolidation of accounts.
2. Commercial banks and other non-bank financial institutions, insurance companies and reinsurance funds, and all companies licensed to conduct securities investment, even when they are not listed in a securities exchange market.
3. By other major entities not listed in an official stock exchange securities when they exceed the limits set by the Council of Ministers for annual revenue and number of employees.

The national accounting standards are required to be adopted by all the remaining economic entities which comply to the law no 9228, dated

29.04.2004 “On accounting and financial statements”.

During 2008 (the first year of NAS adoption), several surveys and studies were initiated by the National Accounting Council of Albania, the Institute of Chartered Accountants, or other academic institutions mainly aiming to study the difficulties and challenges the businesses were experiencing while applying for the first time the NAS. These studies revealed quite a few issues such as: the financial statements were primarily prepared to meet tax obligations rather than management need for information and even less the public need for information; the NAS were not fully and deeply known by the accounting professionals, sometimes even chartered accountants and auditors lacked the necessary expertise to prepare or audit financial statements prepared in accordance with NAS (Miti, Lera, Shini & Keri, 2008). Quite disturbing these facts triggered some synchronized measures undertaken by the NACA to improve the spread of information about the NAS among the field’s professionals.

Not only the NACA, but also the Albanian professional accountants’ institutions, the academic institutions and several regulatory and supervisory bodies were involved in extensive efforts to improve the knowledge of the NAS. According to data from the National Accounting Council, with regard to entities that are required to apply National Accounting Standards, in the first year of their application (2008) only partially did they report financial statements prepared on the basis of NAS, other entities continued with the existing accounting arrangements, while other entities did not prepare financial statements at all, as with previous accounting framework they did not report and maintained the same regime. The latter entities are the micro enterprises and the reason they did not prepare and report financial statements was because they lacked experience and on the other hand they could not afford the cost of bookkeeping and financial statements preparation.

Initially the National Accounting Council concluded that the micro enterprises should be excluded from the obligation to implement the National Accounting Standards. But later on, considering the significant percentage that these entities occupy in the total number of SME-s as well as their importance

for the Albanian economy they could not just be left outside of accounting regulation.

Therefore, the necessary changes were made in the legal framework and a specific standard number 15 “On Accounting and Financial Reporting for the micro enterprises (NAS 15) was drafted and issued being added to the other 14 National Accounting Standards. This standard was intended to present the basic concepts and principles and to establish rules for the implementation of financial reporting rules for the financial statements of these entities. The micro enterprises which have the status of a “physical person” and with annual turnover up to 2,000,000 ALL (15.000 EUR approx.) will hold to a simplified accounting framework and will not be required to prepare financial statements. Other micro enterprises with annual turnover from 2,000,000 to 10,000,000 ALL (15.000 EUR – 70.000 EUR), are required in NAS 15 to maintain accrual accounting registration and prepare only two simplified financial statement, the balance sheet and the statements of income as well as their related records.

Also the Government Decree no 969 dated 30.09.2009 “On the definition of criteria for bookkeeping and preparation of financial statements, for micro enterprises”, brought many changes in the micro enterprises accounting and financial reporting framework. These changes include:

1. Micro-enterprises with the status of a “physical person”, who in the last financial year realize an annual turnover up to 2,000,000 (two million) ALL in the last financial year, will keep simplified accounting, (not double entry registrations and cash based).
2. All other micro-enterprises, regardless of their legal form, which are not included in paragraph 1 of this Decree, shall abide to the accrual accounting rules and according the amendments made to the law no. 8957, dated 17.10.2002 “On small and medium enterprises”, are not obliged to apply national accounting standards.

Finally, an order no. 94 dated 10.11.2009 issued by the Ministry of Finance of Tirana, pursuant to Article 4, paragraph 1 of law no. 9228 dated 29.04.2004 “On Accounting and Financial Statements” as amended, with

the proposal of the NAC declared the national accounting standard no. 15 “On the principles of accounting and financial reporting for micro entities” effective and mandatory to be implemented for the financial statements covering the accounting period that begins on or after 1 January 2009. This standard applies prospectively from 1 January 2009, i.e. without changing the comparative financial statements for the year 2008 and earlier, which were reported under previously existing accounting requirements. Reporting of financial statements for the micro entities is normally based on the assumption that business activity is ongoing and will continue without significant changes in the next 12 months period, except when the activity goes into decline and termination or liquidation within a year having no other alternative for action. The financial statements of micro entities are formulated in such a way as to fulfill the needs of key users:

1. Owners and manager who are interested on analyzing the business performance;
2. Lenders and other creditors who focus on the ability of the business to pay off their obligations;
3. Government who needs to draw short term or strategic economic plans;
4. Tax authorities to be in control of tax assessment;
5. SME and micro entities agencies who want to assess the support required by these entities (such as applications for grants, requests for training and subsidizing services for businesses);

The application of NAS no 15 for the first time was associated with several difficulties for the micro entities such as:

- Radical transition of financial reporting regime, from a simplified reporting of total revenues and expenditures in a comprehensive reporting of all the required financial statements. This transition, as every other change, has caused a lot of disorientation and difficulties for the micro entities staff especially in terms of documenting separated transactions (business-family) and also the sharing of personal assets from business assets. Previously

as many micro entities were family business (Gjoni & Shkurti 2010) the family members did not apply any clear distinction between personal assets and obligations and business assets and obligations.

- The cost of preparing financial statements and maintaining the necessary documentation of transactions was higher than the benefits they had. Most of micro entities did not have the appropriate staff to prepare financial statements, and the transition to NAS 15 meant that they either should hire professionals to do the reporting or should engage their (or any other family member) to be trained for the financial reporting issues.
- Another typical problem faced by the micro entities was the initial difficulty with the electronic submission of payroll and employees turnover during the reporting period. Micro entities are characterized by a high rate of employee turnover. Previously these changes should be reported only periodically, but with the implementation of NAS 15 the micro entities should apply the same procedure as other business which is to report the changes in their staff within 48 hours. This along with the electronic submission of the monthly payroll and the payment of related social security obligations increased the financial and transactional burden the micro entities were facing.

Nevertheless it is important that the micro entities are aware and prepared to accept their obligation to implement this standard. This means that they should be engaged to be included in various trainings. In this respect the economists who work on these entities bear a great responsibility to modernize their working environment thus increasing the overall economic culture of the micro entities which in turn contributes towards the decrease of the informality in Albania.

4. Conclusions

Quite often, the overall education and professional training of

entrepreneurs in the past had no connection with the business that they chose to start. When the first Albanian entrepreneurs started their business in early 90s, most of them believed that “the practice has been the best teacher for them”. But today, when competition has become tougher and the market opportunities are draining, the experience of managers / owners of SME-s more than often are not sufficient for the business continuity and growth. In this context, the innovation and the development of business management capacities is vital for sustainable growth and for taking the micro, small and medium business at a higher level.

In addition the SME sector in Albania is mainly concentrated in the domestic market and lack or fear the international competition. This affects deeply their growth opportunities in international markets. Various reports form national or international agencies, including the periodic progress reports prepared by the European Commission, note that the business environment for SME-s in Albania has had improvements, especially regarding the procedures of registration of companies and access to financing. However, significant gaps remain in terms of human capital development and technological capacity, hindering the ability of the micro, small and medium Albanian companies to compete with the EU SME-s and thus survive to the open market competition in EU. Therefore we recommend that reforms undertaken by the government to support SME-s should continue. Also the creation of SME-s should be facilitated by creating special funds for their financing in an ongoing basis.

Regarding the implementation of the National Accounting Standards in Albania in its earliest phase it was characterized for the majority of economic entities by several difficulties the most prevalent of which, the low number of companies preparing financial statement according the new NAS deeply affected the initial quality of the new accounting and financial reporting framework. The other economic entities which recognized the importance of implementing the Standards and accepted the legal responsibility to do so experienced difficulties and problems regarding the problems of transition from the existing arrangements to the new accounting standards, the measurement, evaluation and disclosure items in financial statements, or adjustment to the

new financial statements, etc.

To achieve the correct and full implementation of IAS / NAS we think that all the involved parties should continue to work towards the awareness of the business environment about the importance of implementing good and comprehensive accounting/auditing and financial reporting standards. Other efforts from professional organizations should also continue such as their involvement to work towards training and qualifications as well as to expand and further intensify cooperation and experience exchange with counterpart regional organizations in the field of accounting and auditing.

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