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Accounting and reporting needs of microenterprises and small and medium-sized enterprises and the role of accounting and reporting in facilitating the formalization of businesses in the informal economy*

Note by the UNCTAD secretariat

Summary

In this background note, the current state of accounting and reporting requirements for microenterprises and small and medium-sized enterprises is reviewed from the perspective of supporting formalization and successful operation and growth. An assessment is provided of the extent to which accounting and reporting requirements affect the formalization of microenterprises and small and medium-sized enterprises. How good quality accounting and financial reporting contributes to the successful operation and growth of such enterprises is discussed, as are additional measures for promoting formalization, such as reducing the burden of accounting and reporting requirements, raising the level of theoretical accounting and reporting knowledge and practical implementation aspects, improving financial literacy and leveraging information technology. Finally, a series of measures is presented for consideration by policymakers, regulators and authorities responsible for supporting the formalization and growth of microenterprises and small and medium-sized enterprises.

* Mention of any firm or licensed process does not imply the endorsement of the United Nations.
I. Introduction

1. The General Assembly of the United Nations, in its resolution 77/160 of 14 December 2022, recognized the importance of microenterprises and small and medium-sized enterprises (MSMEs), indicating that they “globally represent about 90 per cent of businesses and account for over two thirds of employment” and emphasizing “their role in supporting achievement of the Sustainable Development Goals, in particular through promoting innovation, creativity and decent work for all”. Furthermore, “the importance of formalizing micro-, small and medium-sized enterprises, and of encouraging their participation and growth in international, regional and national markets, including through access for all to capacity-building, digital government and business and financial services, such as affordable microfinance and credit,” was recognized.

2. Studies indicate that the informal sector provides employment to a significant proportion of the workforce in many economies. Over the past four decades, UNCTAD has been supporting member States in promoting the formalization and growth of MSMEs through integrated programmes on entrepreneurship policies, business facilitation, and accounting and reporting. For example, Empretec is a flagship capacity-building programme of UNCTAD for the promotion of entrepreneurship and MSMEs to facilitate sustainable development and inclusive growth. A global network of national Empretec centres provides support services to entrepreneurs, including vulnerable groups, with a focus on developing countries. In addition, entrepreneurship training workshops on entrepreneurial skills building are delivered, leading to a worldwide network of over 500,000 trained entrepreneurs.

3. The Intergovernmental Working Group of Experts on International Accounting and Reporting (ISAR) has been making significant contributions towards addressing the accounting and reporting needs of MSMEs. At its seventeenth session, held in July 2000, ISAR identified a number of obstacles faced by MSMEs in applying accounting standards that had been issued by various standard-setting bodies, both national and international. In concluding its deliberations on this topic, at its eighteenth session, in September 2001, ISAR requested the International Accounting Standards Board to “take up this issue as a priority and on a timely basis”. ISAR then embarked on pioneering work to formulate, at a global level, accounting and reporting guidance for MSMEs. ISAR culminated its work on this project in 2003 by issuing accounting and financial reporting guidelines for small and medium-sized enterprises (SMEGA), level 2 and level 3 guidance. The work ISAR conducted influenced thinking at a global level. For example, delegates from Brazil translated the SMEGA level 2 and level 3 guidance into Portuguese and promoted implementation in their country. In Pakistan, the professional accountancy organization published a national version of the guidance materials.

4. In July 2009, the International Accounting Standards Board published the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs). The work undertaken by ISAR provided significant impetus to the International Accounting Standards Board project on preparing the IFRS for SMEs. The International Accounting Standards Board is currently in the process of conducting a review of the IFRS for SMEs. In 2009, ISAR published an updated version of the SMEGA level 3 guidance. In recent years, ISAR has been providing member States with technical support to meet their capacity building needs in the area of accounting and financial reporting by MSMEs. In 2020 UNCTAD published an updated accounting training manual, titled “Training manual on accounting for microenterprises and small and medium-sized enterprises”. The training manual was developed on the basis of the accounting and reporting requirements

1 For example, L Klapper, M Miller and J Hess, 2019, Leverage Digital Financial Solutions to Promote Formal Business Participation, World Bank, Washington, D.C.
2 See https://unctad.org/topic/enterprise-development/Emprtec.
outlined in the SEGA level 3 guidance. The accounting manual was subsequently translated into Arabic, French and Spanish. Training-of-trainer workshops that made use of the manual were held in several countries in Africa, Latin America and the Middle East. The Accounting Development Tool developed by ISAR contains components for assessing regulatory, institutional and human capacity development needs pertaining to the MSMEs sector, with a view to supporting maintenance of proper accounting records and preparation of meaningful financial statements.

5. In concluding deliberations at its thirty-ninth session, the Intergovernmental Working Group of Experts proposed, as a second main agenda item for the fortieth session, the topic of accounting and reporting needs of microenterprises and small and medium-sized enterprises and the role of accounting and reporting in facilitating the formalization of businesses in the informal sector. Accordingly, the UNCTAD secretariat has prepared the present background note to facilitate deliberations on the topic.

6. The main focus of this note is the interplay between accounting and reporting requirements and the formalization and growth of MSMEs. Issues pertaining more to MSMEs on the lower end of the development ladder are highlighted rather than those pertaining to larger and established ones. The rest of this note is organized as follows: chapter II provides an overview of the current state of accounting and reporting requirements; chapter III continues with an assessment of the extent to which accounting and reporting requirements impact the formalization of MSMEs; chapter IV discusses how good quality accounting and financial reporting contribute to the successful operation and growth of MSMEs; chapter V presents considerations for making accounting and reporting requirements more supportive of the formalization and growth of MSMEs; and the final chapter outlines issues for further consideration by delegates at the fortieth session of ISAR.

II. Overview of applicable accounting and reporting requirements

7. A review of currently available data shows a variety of accounting and reporting requirements that are applicable for MSMEs. One of the widely recognized standards applicable for this sector is the IFRS for SMEs noted above. Data published on the use of the IFRS for SMEs by the International Accounting Standards Board indicate that, of the 168 jurisdictions for which it has data, 87 jurisdictions require or permit the use of the IFRS for SMEs; in 11 jurisdictions, the IFRS for SMEs is currently under consideration; and, in 70 jurisdictions, the IFRS for SMEs is not used or under consideration. Of the 87 jurisdictions that require or permit the use of the IFRS for SMEs, 11 are least developed countries. A review of existing requirements also shows that there are no sector-specific (for example, by type of business activity) accounting and reporting requirements for MSMEs to apply.

8. Further details can be found on the jurisdiction profiles of the International Accounting Standards Board and sources at the national level. Some examples of where jurisdictions have separate accounting and reporting requirements for SMEs and microenterprises are:

- Australia has not adopted the IFRS for SMEs. The jurisdiction profile reports that “Australia’s Tier 2 reporting requirements are referred to as Reduced Disclosure Requirements, which is available for general purpose financial reporting by non-publicly accountable entities”.

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• In Brazil, while the IFRS for SMEs has been adopted with some modifications, the jurisdiction profile indicates that “some micro and small entities (gross revenue less than R$3.6 million, which is approximately US$ 1.1 million) are authorized to use a simplified set of accounting standards established under Resolution CFC 1418/2012”8. Entities were required to apply the IFRS for SMEs for years, beginning on or after 1 January 2010. The country currently has three standards for MSMEs: one for micro entities; another for small entities; and still another one for medium entities. All are based on the original IFRS for SMEs, with simplifications.

• The response of Colombia in the Accounting Development Tool refers to Decree 2420 of 2015, Annex III, which describes the technical regulatory framework applicable to microenterprises. “This is a local regulation that meets IFRS principles in a simplified way, as it is based on [the] IFRS for SMEs. It looks for establishing a simplified regime of accounting to generate basic financial information and to facilitate the formalization of businesses. In this regulatory framework, the criteria for classification as microenterprises (also known as simplified regime) are based on previous regulation: Tax Regime Art. 49”.9

• In India, the Institute of Chartered Accountants of India10 reports that, for the purpose of applicability of accounting standards, enterprises are classified into four categories, namely, level I, level II, level III and level IV non-company entities. Level I non-company entities are large entities that are required to apply all the standards. Level IV, level III and level II non-company entities are considered to be MSMEs and have been granted certain exceptions from accounting standards applicable for larger entities.

• In Nigeria, “all SMEs as defined in the law are required to use the IFRS for SMEs standard, effective 1 January 2014, except micro-sized entities (as defined in law), which may choose the IFRS for SMEs standard or the small and medium-sized entities guidelines on accounting (SEMEGA), level 3, issued by the United Nations Conference on Trade and Development”.11

• The United Kingdom of Great Britain and Northern Ireland has a Small Company Regime that allows small entities to comply with the lesser requirements in Financial Reporting Standard 102 which, although based on the IFRS for SMEs, has significant differences.12

• In the United States of America, the American Institute of Certified Public Accountants has issued the Financial Reporting Framework for Small- and Medium-Sized Entities, which is an additional, non-generally accepted accounting principles financial reporting option.13 “The framework draws upon a blend of traditional methods of accounting with some accrual income tax methods. It consists of simplified principles and focuses on the most relevant information needs of Main Street America and their financial statement users”.14 “This framework is intended as a self-contained ‘other comprehensive basis of accounting’ for smaller to medium-sized, owner-managed, for-profit, private companies that are not required to

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14 Ibid.
produce financial statements in accordance with [United States] [generally accepted accounting principles]."\(^{15}\)

9. Despite the availability of simplified accounting and reporting standards specifically developed for MSMEs, there are indications that business owners face difficulties in maintaining accounting records and preparing meaningful financial statements. For example, a study carried out in Indonesia shows that, although the country has made available a national accounting standard that was developed using the IFRS for SMEs as a reference point, MSMEs owners cite various reasons for not keeping accounting records, as, for example, “it costs more (relative to benefits); accounting and financial reporting are not required; and accounting is difficult/complicated; no staff understand accounting”.\(^{16}\)
The study carried out in Indonesia also notes additional reasons that MSMEs cite as factors that prevent them from keeping accounting records, such as the following:

   (a) “There is a presumption that the recording of transactions is not necessary and so, when implemented it is a waste of time and energy.

   (b) There is a presumption that recording transactions is not very useful in supporting daily operations and activities.

   (c) Business managers are more focused on the production activities of daily routine business management (e.g. goods shopping, taking care of the workforce, etc.) and taking care of their trading transactions – so there is not time for recording.

   (d) SMEs owners have limited knowledge of how to keep financial records.

   (e) It is assumed that the complete recording of transactions will result in an increase in the amount of taxation to be paid.”\(^{17}\)

10. A study of MSMEs conducted in Jordan highlights similar findings.\(^{18}\) A majority of the microenterprises included in the study (64.9 per cent) does not keep financial records. The study notes that lenders performing financial analysis face challenges in relation to the accuracy of accounting records presented by MSMEs in support of loan applications. Accounting records are “deliberately misstated in order to reduce the… tax burden [of MSMEs]”. The study also indicates that some MSMEs maintain a separate set of unofficial accounts.

11. Another study, conducted by the Asian Development Bank in Kazakhstan, highlights that “banks are more focused on serving medium-sized businesses and larger small enterprises. When applying for a loan, entrepreneurs have to comply with strict requirements of banks for collateral, financial reporting and credit worthiness. The smaller the business, the less prepared it is to meet such requirements, as it is less formalized and capitalized, has poorer financial and accounting discipline, and possesses assets/collateral in remote regions with low market values”\(^{19}\).

12. Providing proportionate accounting and reporting requirement has to be supplemented by additional measures to encourage MSMEs to adopt and apply standards in an effective and efficient manner. These will be discussed further in the remaining chapters of this note.

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\(^{15}\) See https://www.ifrs.org/content/dam/ifrs/publications/jurisdicitions/pdf-profiles/united-states-ifrs-profile.pdf.


\(^{17}\) Ibid.


III. The impact of accounting and reporting requirements on promoting formalization

13. For an informal enterprise to make the transition into the formal economy, business registration is required, which will differ in different jurisdictions. The legal structure chosen by the informal enterprise (for example, sole trader, partnership, company, trust, personal liability company) for registration dictates the registration requirements. As the example of Uganda shows (see box), information on the most suitable entity form can be found on websites that support SMEs.

14. Many jurisdictions that offer online registration have similar requirements for the provision of information. Using Uganda as an example, no accounting and reporting requirements need be met upon registration as a company (see box). However, the country requires compliance with tax formalities indicating that financial records may need to be produced to support the filing of applicable tax returns. However, if an existing MSME intends to formalize its operations and trade as either a sole proprietor or a partnership, while requirements for company registration would not be applicable, it would still need to fulfil tax obligations and obtain applicable licences and permits.

Steps to register a company in Uganda

1. **Choose a company name**
   Choose a name for your company that is unique and has not already been registered in Uganda.

2. **Reserve the company name**
   Once you have decided on a name for your business, you may reserve it by paying a fee.

3. **Draft the Memorandum and Articles of Association**
   The Memorandum and Articles of Association are legal documents that explain your company’s purpose and activities, as well as the rules and regulations that govern how it operates.

4. **Register with the Uganda Registration Services Bureau**
   You can register your company with the Uganda Registration Services Bureau by submitting the Memorandum and Articles of Association, the company name reservation certificate and other essential forms, such as director and shareholder identity documents, as well as proof of registration fee payment.

5. **Obtain a tax identification number**
   You must get a tax identification number from the Uganda Revenue Authority after registering your company with the Uganda Registration Services Bureau (Uganda Revenue Authority). This is essential in order to pay taxes and do business in Uganda.

6. **Register for value added tax**
   If your company is expected to generate more than U Sh50 million in annual revenue, you must register with the Uganda Revenue Authority for value added tax.

7. **Obtain other relevant licences and permits**
   Depending on the nature of your business, you may need to obtain other relevant licences and permits from government agencies or local authorities.

Company registration requirements in Uganda also includes submission of:

- Three preferred names of the proposed company
- A description of the activities of the business/company
- Copies of travel passports of all the directors and shareholders (a limited liability company should have at least two shareholders)
• Passport size photographs of all the directors and shareholders
• Postal, physical and email address, telephone number and occupation of all shareholders/directors of the proposed company
• Share apportionment percentage.

How long does it take to register a company in Uganda?

The process of registering a company in Uganda can take several days to complete. There are three major steps that need to be undertaken in order to have a full-fledged company in Uganda. These are:

<table>
<thead>
<tr>
<th>Major step</th>
<th>Number of days</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company registration</td>
<td>10</td>
</tr>
<tr>
<td>Revenue authority registration</td>
<td>5</td>
</tr>
<tr>
<td>Bank account opening</td>
<td>7</td>
</tr>
</tbody>
</table>

Thus, it takes a total of 22 days to have a full-fledged company registered.

Source: AfriSetup.

15. An MSME that has a trading history and up-to-date accounting records will be in a better position to determine which entity form is more appropriate, the cost/benefit implications of converting to a formalized entity form and its ability to meet tax obligations. An MSME that decides to formalize its operations as a company should have a business plan, as there may be several shareholders who will want to ensure that the company will operate profitability in the future. An MSME wishing to attract other shareholders or borrow from family and friends would need to provide evidence that the business is on a sound financial footing and is currently profitable and will remain profitable in the future. That evidence would be produced using accounting and reporting information.

16. Once an informal enterprise chooses to enter the formal economy, proper record keeping is important to ensure the business remains compliant, as this will “inform planning, help promote operational efficiency and is critical when applying for funding”. Different jurisdictions will have different requirements for financial reporting and documentation. While some of the benefits of formalization are business name protection, business compliance and access to government tax incentives and financial assistance, MSMEs often consider the downside to operating in the formal sector as meeting any formal requirements, including compliance with laws that will increase their operating costs. Compliance with tax laws must also be done in a timely manner, according to the requirements of the jurisdiction (for example, monthly, annually and so on) to avoid any penalties and thus necessitating up-to-date recording.

IV. The role of accounting and reporting in promoting successful operation and growth

17. Sound accounting information is essential for operating a business in a profitable manner and supporting its growth. Properly maintained accounting records and meaningful financial statements facilitate access to finance and services. Raising the level of financial literacy of business owners is important for proper utilization of accounting information.

A. Access to finance

18. To obtain finance, registered financial intermediaries will require an MSME to meet their criteria for borrowing. These criteria may be related to the age of the applicant, various income or turnover thresholds, a good credit history, an existing bank account and a certain number of years of trading. This suggests that a newly established business without a history of profitability, without a bank account and without assets to act as collateral may find it difficult to access finance. This emphasizes the importance for MSMEs of being able to meet applicable accounting and reporting required by financial intermediaries to access finance. This also highlights the importance for MSMEs of having accounting skills to prepare the necessary information required by financial intermediaries. These requirements also need to be met to access service providers, such as insurance providers, and to be granted credit facilities by suppliers. It is unlikely that an unformalized and unbanked MSME would be able to access finance from a registered financial intermediary, and the likely source of finance for such an MSME would be bank lending (should it have a bank account) or borrowing from family and friends.

19. In a report titled Financial Inclusion for Development: Better Access to Financial Services for Women, the Poor and Migrant Workers, UNCTAD indicates that “the lack of access to finance is the biggest obstacle affecting MSMEs and start-ups in developing countries. Start-ups are particularly credit constrained, as lenders have little information on their performance or credit worthiness. Firms in the informal sector face major challenges in accessing finance, as many do not have bank accounts to run their business”. Some of the reasons that MSMEs and individuals remained unbanked “in developing economies are the lack of disposable money, the costs of transactions, and documentation requirements. These barriers tend to have a disproportionate effect on the poor, women, youth, rural populations, informal workers and migrants. In all regions and income groups, the proportion of women with financial services accounts is lower than the average. Youth demonstrates even a lower ratio, with the exception of sub-Saharan Africa. The largest disparity between women and the total population of 8 percentage points is observed in the Middle East and North Africa”.

20. The UNCTAD Entrepreneurship Policy Framework provides a number of policy recommendations for improving access to finance. It outlines key policy objectives and options. The main policy objectives contained in the framework are improving access to relevant financial services on appropriate terms; promoting funding for innovation; building the capacity of the financial sector to serve start-ups; and providing financial literacy training to entrepreneurs and encouraging responsible borrowing and lending. Policy options and recommendations of the framework in relation to financial literacy training for entrepreneurs and encouraging responsible borrowing and lending include setting up financial accounting literacy training, undertaking appropriate supervision of financial products offered to social and microentrepreneurs; and expanding private credit bureau and public credit registry coverage.

21. The International Finance Corporation provides several case studies in its 2014 publication titled Enhancing SME Access to Finance. The report notes that “SMEs themselves report lack of access to finance to be one of the greatest barriers to their growth. Half of SMEs in emerging markets are credit constrained,” and 70 per cent of MSMEs have no access to external finance and 15 per cent are underfinanced. It is therefore necessary for MSMEs wanting to formalize and access finance to have a banking history and financial education, which includes the ability to prepare accounting information.

21 UNCTAD, 2021 (United Nations publication, Geneva).
B. Access to services

22. A 2017 Organisation for Economic Co-operation and Development working paper reports that MSMEs are more reliant on traditional bank lending and that changes in bank regulations can affect MSMEs adversely. Furthermore, banks treat MSMEs more strictly than larger enterprises. For example, the Small Enterprise Finance Agency in South Africa is aimed at registered businesses and not at MSMEs, and an unformalized MSME would not be able to access finance from the Agency.

23. The types of insurance that a formalized MSME may require, according to the jurisdiction where it is operating and its type of operations, are those related to employees, such as worker’s compensation or other social insurance required by local legislation and other types, such as employer’s liability, personal accident, general third-party liability, professional liability and any vehicle insurance. An unformalized MSME would not be eligible for these types of insurance and risks the possibility that it is trading without the security that insurance provides.

24. Numerous websites offer advice on how to grow the customer base of an entity; what is common is the need for good customer service (both at the time of sale and post-sale), gaining customer trust and using web marketing. These criteria suggest that sales need to be priced fairly and that returns or warranties should be offered. An MSME would use accounting information to make pricing decisions and a history of returns, to be able to make any provisions for sales returns and warranty decisions. The advantages for an MSME of creating an online presence are being able to increase and diversify its sales, provide both an online and physical presence, allowing customers to buy online.

25. The preceding discussion indicates that, for the successful operation and growth of an MSME, it would need access to finance when and if needed, and insurance should be in place for both business and employee protection reasons and to enable the MSME to increase sales.

C. Financial literacy

26. One of the main pillars of the UNCTAD Entrepreneurship Policy Framework is focused on enhancing entrepreneurship education and skills development. The framework outlines that “entrepreneurial skills centre around attitudes (soft skills), such as persistence, networking, and self-confidence on the one hand and enabling skills (hard skills) on the other hand, including basic start-up knowledge, business planning, financial literacy and managerial skills. Effective entrepreneurship education policies and programmes focus on developing these entrepreneurial competencies and skills, which are transferable and beneficial in many work contexts. The aim is not only to strengthen the capacity and desire of more individuals to start their own enterprises, but also to develop an entrepreneurial culture in society”.

27. Another pillar of the UNCTAD Entrepreneurship Policy Framework that deals with improving access to finance highlights the importance of financial literacy for facilitating entrepreneurs’ access to finance and encouraging responsible borrowing.

28. An Organisation for Economic Co-operation and Development working paper titled Financial Education for MSMEs and Potential Entrepreneurs provides a working definition of financial education for entrepreneurs (building on their original definition of financial education), as follows:

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Financial education refers to the process by which MSMEs and potential entrepreneurs:

- Recognize the interaction between personal and business finance
- Know where to go for help
- Improve their understanding of the financial landscape, products, and concepts of relevance
- Through information, instruction and/or objective advice, develop the skills, knowledge, attitudes and confidence to:
  - Become more aware of financing opportunities and financial risks and opportunities
  - Make informed business plans and related choices
  - Manage their financial records, planning and risks effectively over the short and long term
  - Take other effective actions to maximise the potential of their business for the benefit of their enterprise and that of the wider economy (p. 9).

29. This definition refers to several concepts inherent to accounting knowledge. For example, the interaction between personal and business finance is linked to the entity concept, one of the key concepts in financial accounting. Knowledge to understand the financial landscape, financing opportunities and risks, make informed business plans and manage financial records would imply financial knowledge (i.e. accounting knowledge). Entrepreneurial skills would also form part of financial education. Many studies do not differentiate between financial literacy, entrepreneurial skills and accounting knowledge, and label these skills as “business skills” or as “financial education”.

30. The same working paper highlights that “entrepreneurs who fail to keep proper accounting records, and those who do not provide transparent and standardized financial statements and information, make it difficult for lenders to assess the intrinsic risk of their company, irrespective of size”. These findings indicate that an MSME that has mastered the necessary financial education skills, which include accounting knowledge and entrepreneurial skills, may be in a better position to access finance as the MSME would be able to produce sufficient financial evidence that a loan to it is a viable proposition. In the working paper, it is likewise maintained that “there is a clear case for more and better financial education for MSMEs using financial technology platforms to raise financing. Increased financial literacy can allow MSMEs to take advantage of the opportunities for alternative (and cheaper in many cases) funding, while at the same time being aware of the risks involved in the use of such platforms, their real costs and their limitations”.

31. Another Organisation for Economic Co-operation and Development study, titled Financial Education for Micro, Small and Medium-sized Enterprises in Asia, indicates that financial education or financial literacy is a broad topic and only in Malaysia (out of 21 countries) did the content refer to “improve basic accounting skills”. A 2021 inventory of small business training indicates that not all small business training includes a focus on accounting. This indicates that, while there is a need for financial education, per se, there is also a need for financial education to focus more on accounting and reporting matters.

27 Ibid., p. 22.
V. Making accounting and reporting requirements more supportive of formalization and growth

32. Policymakers, regulators and authorities responsible for supporting formalisation and growth of MSMEs could consider several options to support successful operation and growth of MSMEs. Some of the key considerations have already been elaborated above. These include reducing reporting and registration requirements for MSMEs and providing the informal sector with training on financial accounting, financial literacy and entrepreneurial skills.

A. Simplifying accounting and reporting requirements

33. As discussed in chapter II, several jurisdictions have taken measures to reduce accounting and reporting requirements for MSMEs. A further example is that, in South Africa, smaller companies are not directed towards any framework provided certain criteria are met, and these companies could use a simple accrual model or even only record cash transactions.

34. A 2019 study by the Organisation for Economic Co-operation and Development cautions that “[t]o enhance regulatory conditions for SMEs, there is no one-size-fit-all model. Key elements for SMEs include: simplification of regulations and administrative procedures, regulatory impact assessment, reforms to tax administration and bankruptcy procedures, including to promote a second chance for honest entrepreneurs, improved availability and provision of information, and use of digital technologies to reduce administrative burdens and facilitate collaborative relationships with businesses and citizens”.

35. Many requirements for registration and continuing operations tend to be subject to the laws in the relevant jurisdictions. However, some countries do have strategies in place to provide MSMEs with tax relief. A South African example would be the turnover tax system applicable to qualifying small businesses, which is a single tax system replacing all other taxes.

36. Since 2013, the Inland Revenue Authority of Singapore has made available for qualifying MSMEs a concise guide for simplified record keeping requirements. The guide highlights the following on the importance of record keeping for business owners: making better business decisions; being aware of the financial status of their business; and reducing the cost and effort required to file annual income tax return and reply to queries from the tax authority. The main record keeping requirements are: a daily revenue record; daily purchases record; monthly record of all business expenses; details of daily transport expenses; and details of monthly staff remuneration expenses. The guide provides examples of statements of accounts and a balance sheet.

B. Raising the level of accounting and reporting knowledge and improving financial literacy

37. There are several actors that can provide MSMEs with accounting knowledge and support with practical implementation. These could be initiatives set up by Government, non-governmental organizations, financial service providers and professional accountancy organizations. Several reports or studies document various jurisdictions where these role players are providing MSMEs with accounting and reporting knowledge, often under the umbrella of financial education or business training. Some examples are discussed below.


38. As indicated in chapter I, UNCTAD has made available for member States a training manual on accounting for microenterprises and small and medium-sized enterprises in Arabic, English, French and Spanish. The manual has four modules covering an introduction to accounting, the accounting cycle, the components of financial statements, and interpretation of financial statements and access to finance. The final module is designed to enable trainees to gain a better understanding and practical use of financial statements, including for facilitating access to finance. As an initial step, member States could consider training a core group of trainers by using this manual and then rolling out the training programme to trainees in different parts of the country.

39. The Association for Chartered Certified Accountants reports that the accountancy profession plays a significant role in addressing this challenge. Professional accountants have a broad-based knowledge in accounting and business and can work with Governments and other relevant institutions, such as SME bodies, to provide financial literacy and management training for owner-managers. The Association for Chartered Certified Accountants argues that it has already organized its members to run financial clinics, and worldwide “this grassroots engagement is the most authentic and effective means by which the skills of the SME sector can be improved.” The Association’s Global Forum for SMEs “urges international organizations to work with national Governments to encourage much wider use of such initiatives to raise the level of skills, with a particular emphasis on working with the existing SME intermediaries to enable reliable access to the sector”.

40. The 2017 Organisation for Economic Co-operation and Development working paper mentioned above provides practical examples of initiatives in 19 countries which focus on financial and entrepreneurial education. A 2021 paper provides an inventory of different role players and their strategies. In the paper, it is noted that business training programmes to help new and existing small firms improve their business practices are offered by “many Governments, microfinance organizations, non-governmental organizations and private providers”. Examples mentioned include the Start and Improve Your Business programme of the International Labour Organization, which “has a network of over 65,000 trainers and estimates that at least 15 million clients have been trained”; Cefe International reports having more than 20,000 trainers qualified in its methodology in 140 countries and having trained 20 million participants; and the National Institute for Entrepreneurship and Small Business Development of India “reports having provided 44,035 different training programmes to more than 1.1 million people. These are all cumulative numbers since the programmes started”. It is also noted that, although information is fragmented and incomplete, estimations indicate at least $1 billion is spent annually training at least 4–5 million potential and existing entrepreneurs in developing countries.

41. A 2023 global report finds a number of initiatives in different countries, one of which is that, in 2022, the Ministry of Economy in Chile launched the “Digitalize Kit” platform to provide SMEs and entrepreneurs access to growth tools, including digital marketing, e-commerce, shipping and despatch, means of payment, connectivity and cybersecurity.

42. As indicated above, usually financial literacy skills include accounting and reporting knowledge and often entrepreneurial skills, too. Most of the studies mentioned in the section above also focus on financial literacy and entrepreneurial skills. Jurisdictions have their unique strategies or role-players tackling the need to improve financial literacy and entrepreneurial skills and, in so doing, improving MSME growth. This is important, as the Association for Chartered Certified Accountants reports that evidence is emerging of the

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34 Atkinson, 2017.
36 See https://cefe.net/about-us/.
link between the in-house financial capability of businesses and their ability to grow rapidly but sustainably.  

43. In the 2021 inventory paper, it is noted that firms using better business practices are more profitable and grow faster over time and that better management does matter for firm productivity and growth among SMEs. Furthermore, SMEs in developing countries are not using basic business practices, such as keeping records, advertising their goods, budgeting and planning and, therefore, policymakers need to promote business training programmes.

44. Three approaches are suggested in the same paper that could be used to build financial literacy. The first is to ask the user (in this case, the MSME) to pay (at least in part) for the training programme. However, this risks the exclusion of unformalized MSMEs that may already have liquidity concerns. The second is to use online technology (television programmes, SMS, apps) to offer business training. This has the advantage of lowering the costs to meet the training needs of a multitude of MSMEs. A third approach is for policymakers to target programmes towards the firms that will benefit most from such training. The challenge here is identifying these firms. Choosing which type of approach to be used may depend on the resources of different jurisdictions. It is important that measures are also put in place to assess the success of any programmes, preferably using quantitative indicators.

45. A 2019 study published by the World Bank cautions that “[f]inancial education generally isn’t effective when provided through classroom training on accounting concepts or numeracy. It can be more effective when linked to participants’ real-world experiences.” The example provided in the study takes place in the Dominican Republic, where “a microfinance institution taught clients practical tips for day-to-day business management, such as storing business and personal cash in different places. Participants who received the training were more likely to adopt the good business practices compared to a group which did not receive the training and another group which received old-fashioned financial education on accounting”.

C. Promoting digital record keeping and utilization of digital financial services

46. Nowadays, businesses need a digital footprint, and the lockdowns associated with the coronavirus disease (COVID-19) accelerated the use of online shopping and drove many businesses online. MSMEs that want to reach new customers and clients will need to consider having an online presence. Businesses are being forced to create a digital footprint as paper-based transactions have become scarce. One example is the phasing out of cheque payments and the need to use electronic funds transfers or mobile money transfers.

47. The UNCTAD Digital Economy Report 2021 underscores the fact that the state of play in the data-driven digital economy is highly uneven: “In order to participate in and benefit from this economy, countries need to be able to access relevant communication technologies, which are the basis for the transmission of data. They also need to have the capabilities to make productive use of such access. There are still significant divides, within and among countries, in terms of capacities to connect to and use the Internet. Addressing these inequalities in the digital economy is key for development” (p. 8). Since 2010, all groups of countries by level of development have experienced significant growth in mobile broadband penetration rates. However, large gaps remain over a decade later: the penetration rate in developed countries is double that of developing countries, and four times that of the least developed countries. In terms of Internet activities undertaken by

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38 Association for Chartered Certified Accountants, 2012, p. 5.
40 Ibid.
41 Klapper et al., 2019, p. 23.
42 Ibid.
individuals, Internet banking was: 62.3 per cent in developed economies; 14.9 per cent in transition economies; 9.8 per cent in developing economies in Africa; 34.8 per cent in developing economies in Asia; and 11.6 per cent in developing economies in Latin America and the Caribbean.44

48. A report by the International Trade Centre, which surveyed more than 2,200 MSMEs in 111 countries, highlights key challenges that MSMEs face when engaging in e-commerce. The report notes that “companies in developing countries face greater challenges earlier on in the establishment phase. About 37 per cent of respondents from [the least developed countries] and 34 per cent from developing countries report being held back from e-commerce by a lack of technical skills and business knowledge, whereas that figure is only 26 per cent among respondents from developed countries. By comparison, companies in developed countries report experiencing more challenges in the operational phase. Roughly 30 per cent of respondents from developed countries reported that online visibility was one of their major bottlenecks in e-commerce, while only 24 per cent of respondents from developing countries, and 19 per cent in the least developed countries, reported this as one of their main challenges.”45

49. In a 2020 study, the Global System for Mobile Communications Association reports that “as of 2017, approximately half of informal business owners globally and in developing countries had a mobile money account or an account at a bank or other formal financial institution”.46 Furthermore, informal MSMEs rely heavily on the use of cash and using mobile money “promotes productivity and profitability by reducing operational costs and making commercial transactions cheaper, more fluid and secure”.47 Mobile money is useful also as, in many areas where MSMEs operate, a physical presence of banks and branches is lacking. Mobile money is stored on an application usually provided by a network provider (for example the Momo app used in South Africa). Another mobile money service is M-pesa, which is considered Africa’s most successful mobile money service and the region’s largest financial technology platform. M-Pesa allows payments to be made across Africa, both for the banked and unbanked. However, an Internet-enabled smartphone may be needed to be able to download the various applications. Linking financial services to a mobile money application may be one possible method to encourage MSMEs to use digital financial services.

50. One impediment to use digital services is the high cost of data. The World Economic Forum estimates that the “average price of the fixed-broadband basket (5 GB) is at least 20 times higher in developing economies than in advanced economies, and the price that customers pay for a fixed-broadband basket is more than one-sixth of their salary. More efforts are needed to improve affordability, expanding inclusion of companies and households into the digital economy.”48

51. As noted above in chapter III, for MSMEs to become formalized, access to banking facilities is useful, as it would give them access to accounting and reporting knowledge provided by their banking partner. This suggests that financial institutions, such as banks, have a role to play to ensure that their clients have the required financial knowledge to manage their banking transactions and to take advantage of the educational materials and programmes banks provide to their clients.

52. The Global System for Mobile Communications Association suggests that MSMEs be encouraged “to build a digital record by raising awareness of how data from the use of mobile money can be combined with other information for creditworthiness assessments.

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46 Global System for Mobile Communications Association, 2020, Mobile money: Driving formalization and building the resilience of MSMEs, London, p. 9.
47 Ibid., p. 10.
This should be accompanied by programmes to build financial literacy and train business owners to use digital financial services”.\(^{49}\)

53. It would seem necessary that the ability to use mobile money and bank account data to produce basic financial statements should be emphasized to MSMEs. Training showing MSMEs how this could be done would raise awareness of this benefit of using digital resources.

54. For Governments that want to clarify, publicize and simplify administrative procedures on the Internet, the UNCTAD business facilitation programme offers a series of tools and methodologies.\(^{50}\) The business facilitation programme includes three sequential components: eRegulations, eSimplifications and eRegistrations. Through these components, administrative procedures are shown step by step from the user’s point of view. For each step, the following data are provided: contact data (entity, office, person in charge), the expected result of the step, required documents, cost, duration, legal justification and ways to complain. Administrative procedures can be clarified through an eRegulations portal (e.g. company creation, tax payment, import and export). El Salvador uses the online registration system implemented by UNCTAD. This allows Salvadoran entrepreneurs to comply with all mandatory registration requirements in just two steps, as documented by UNCTAD: “Out of El Salvador’s economically active population of 2.75 million, 1.9 million operate in the informal sector. In order to be able to work legally in El Salvador, entrepreneurs are obliged to register with the Ministry of Labour, the Ministry of Finance, the Registry of Commerce, and the municipality. Since the inception of MiEmpresa.gob.sv, entrepreneurs in San Salvador have been able to register simultaneously with all the above authorities to join the legal economy”.\(^{51}\)

D. Additional considerations

55. At a national level, the national accounting standard-setter and/or professional accountancy organizations, or their equivalents, can promote a simplified accounting framework that MSMEs can use on their first steps towards formalization. Consideration could be given to a simplified historical cost model or even cash-based accounting, as many MSMEs will be operating using cash or mobile money accounts.

56. At an international level, the International Accounting Standards Board, or equivalent, should consider a framework that is less onerous than A Guide for Micro-sized Entities Applying the IFRS for SMEs (2009),\(^{52}\) and place the accounting needs for MSMEs, including microenterprises on their way to formalization, on their future agendas.

57. Ad hoc consultations conducted by UNCTAD to examine the role of accounting and reporting requirements in facilitating financial inclusion outlined several options for consideration, including: \(^{53}\)

- Inclusion of accounting and financing training in school curricula at an earlier stage;
- Consideration by professional accountancy organizations of awarding of continuing professional education credits to their members when they engage in training entrepreneurs on accounting and financial reporting on a voluntary basis;
- Establishment of centres where entrepreneurs would be able to receive mentoring to help them pursue their business ideas.

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\(^{49}\) Global System for Mobile Communications Association, 2020, p. 15.

\(^{50}\) See https://unctad.org/topic/enterprise-development/business-facilitation.


\(^{52}\) International Accounting Standards Board, 2013, London.

VI. Issues for further consideration

58. In this background note, the focus has been on the importance of maintaining proper accounting records and preparing meaningful financial statements for the profitable operation and growth of MSMEs and for maintaining a formal business status. In addition to the issues presented in the note, delegates at the fortieth session of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting may wish to consider the following questions:

(a) What are the main accounting and reporting-related challenges that microenterprises face in becoming formalized entities and staying in the formal sector?

(b) How can these challenges be overcome?

(c) What actions could policymakers take to incentivize MSMEs to enter the formal economy?

(d) What are some good practices that regulators could adopt to facilitate financial and tax reporting by MSMEs?

(e) How can Internet-based information technology platforms be utilized to facilitate, for MSMEs, the maintenance of accounting records and periodic filing requirements?

(f) What needs to be done to support MSMEs to enable them to prepare high-quality sustainability reports?

(g) What could global forums such as ISAR do to further facilitate the formalization and growth of MSMEs?