GAPSME Disclosure Requirements

1. Introduction
Small and Medium Enterprises (SMEs) are important contributors to a country's economic growth and development and therefore, an environment that is conducive to such entities to do business should be encouraged. This also applies to the suitability of their financial reporting regulatory framework, as financial reporting for SMEs should not be a burden on their resources. This article presents the empirical results of a study based on the extent of disclosure in a sample of small entities' financial statements that are prepared in line with the General Accounting Principles for Small and Medium-Sized Entities (GAPSME) in the first year that this became effective in 2016.

GAPSME is the result of the transposition of the EU Accounting Directive 2013/34/EU into Maltese legislation, the objectives of which are namely that of facilitating cross-border investment, and enhancing comparability and public confidence in financial statements through consistent disclosures. A high level of disclosure in line with GAPSME disclosure requirements is considered as a proxy for high quality reporting. This is fundamental as the "Financial statements of all business entities, including SMEs, must be of high quality to provide useful information to their users" (Mošnja-Škarea and Galant, 2013, p. 345).

GAPSME was based on the original General Accounting Principles for Smaller Entities (GAPSE), which itself was consistent as much as possible with International Financial Reporting Standards (IFRSs) and with a conceptual framework almost identical to that of the International Accounting Standards Board (IASB) for listed entities (Micallef, 2009). There are however various differences between IFRS as adopted by the European Union (EU), GAPSME and GAPSE. Although the coming into effect of GAPSME in Malta was not a major shift in accounting culture, it was nevertheless a learning process. A number of studies (for example, Al-Htaybat, 2018; Day and Taylor, 2005; Jaruga et al., 2007; and Obradovic et al., 2018) have identified challenges of switching from one accounting system to another and suggest that such a learning process can take several years to adjust to. Consequently, a high extent of disclosure is not expected in the first few years of adoption.

2. The degree of disclosure in prior studies
Literature in this area is mostly centred around the determination of the extent of disclosure with IFRS mandatory disclosure requirements (Tsalavoutas et al., 2014). Some studies draw data from a single country. One such study is that carried out by Owusu-Ansah and Yeoh (2005), who examined the extent of disclosure of around 50 listed entities in New Zealand over a three-year period and found that the average degree of disclosure increased over the years. Other studies draw data from multiple countries. The study carried out by Hartwig (2015) drew data from Sweden and the Netherlands, and found that in both countries, the extent of disclosure increased over time.

Most prior studies employ a size filter and focus on larger or listed entities, such as that of Demir and Bahadir (2014) who investigated the degree of disclosure in relation to IFRS by 168 listed entities in Turkey. Other studies concentrate on smaller or developing markets and a few studies focus on SMEs. The study conducted by Mosnja-Skare and Galant (2013) serves as one such example. They analysed the degree of financial reporting disclosures related to revenues and expenditures of Croatian SMEs, as required by Croatia's national Generally Accepted Accounting Principles (GAAP), and found that medium-sized entities disclosed more information than smaller entities. This may be due to the relatively limited resources that smaller entities often have at their disposal.

Furthermore, while some studies focus on a few individual financial reporting topics, others look at the degree of disclosure in connection with a variety of such topics. Tsalavoutas et al. (2020) note that across the post-2005 literature addressing multiple topics, the average degree of disclosure lies between 70% and 90%. Additionally, Tsalavoutas et al. (2020) note that the literature shows that a degree of disclosure at a level below 70% is also commonly scored by entities. A degree of disclosure lower than 100% means that the extent of disclosure can be improved.

3. The Disclosure Index
For the purpose of this study, the sample used consists of 116 randomly selected small private entities

having their first financial statements for the financial year starting on or after 1 January 2016 prepared in accordance with GAPSME. In order to ensure content validity, the research instrument used to measure the degree of disclosure is the MIA GAPSME disclosure checklist. This was adjusted to meet the requirements of the study, resulting in 162 disclosure items.

The extent of disclosure is measured using the Disclosure Index method, as first adopted in Cooke (1992). This is calculated as a ratio of the number of disclosure items that are disclosed, divided by the total amount of disclosure items that are applicable to the entity, as shown in the following equation, where *Cj* is the score for each entity, *T* is the total number of items disclosed (*di*) by entity *j*, and *M* is the maximum number of applicable disclosure items for entity *j* that could have been disclosed. Each item is scored as 1 if the entity disclosed that item of information, 0 if not disclosed, or N/A if not applicable, resulting in the Disclosure Index standing between 0 (0%) and 1 (100%). A high Disclosure Index indicates a high degree of disclosure when compared with the disclosure requirements set out in the financial reporting framework in question.

$$C_j = \frac{T = \sum_{i=1}^{n} d_i}{M = \sum_{i=1}^{m} d_i}$$

4. The degree of disclosure

Descriptive statistics, summarising the results on the Disclosure Index for the sample used in this study is presented in Table 1.

Variable	Disclosure Index
Mean	80% (0.80)
Max	100% (1.00)
Min	40% (0.40)
Std dev	13% (0.13)
N	116

Table 1: Descriptive statistics for the Disclosure Index by entity

Table 1 shows that the maximum extent of disclosure was 100% (1.00), indicating that the level of disclosure was maximised, in line with GAPSME disclosure requirements, by one or more entities. The mean degree of disclosure by entity is 80% (0.80) with a 95% confidence level and a margin of error of 9%. This mean degree of disclosure is in line with what was observed in Germany, Bahrain and Turkey, and higher than that in the rest of the countries presented in Table 2. These previous studies focus on listed entities which tend to have greater resources compared to smaller entities.

Country	Study	Mean Disclosure Index
Germany	Glaum and Street, 2003	81% (0.81)
Bahrain	Juhmani, 2017	81% (0.81)
Turkey	Demir and Bahadir, 2014	79% (0.79)
Saudi Arabia	Alsaeed, 2006	33% (0.33)
Bangladesh	Akhtaruddin, 2005	44% (0.44)
Switzerland	Street and Gray, 2002	74% (0.74)
Jordan	Naser, 1998	63% (0.63)

Table 2: Mean Disclosure Index in other countries

The frequency distribution of the Disclosure Index scores for the 116 sample entities is displayed in Table 3. In line with the framework of analysis used in previous studies, a distinction is made between four levels of entity degree of disclosure, ranging from a high degree of disclosure represented by a Disclosure Index of 80% or more, to a major gap between entity disclosure practices and GAPSME disclosure requirements when the index is below 40%. Given the results presented in Table 3, the majority of the entities scored 80% or more, suggesting that these entities disclosed the majority of GAPSME disclosure requirements.

The main topics denoting room for improvement are analysed in Table 4, focusing on the GAPSME topics applicable to more than 20% of the sampled entities, where the mean Disclosure Index is 80% or less. The main respective disclosures that could be improved are also presented.

5. Key findings and concluding note

When a new set of requirements is adopted, it is a learning process and may thus take a while for entities to acclimate, adjust and fully master the specialised knowledge and skills involved (Wang, 2019). This has also been evidenced in previous studies focusing on the transition to IFRS (for example, Gallery, 2009) suggesting that the extent of disclosure may improve following the first few years of adoption. Nevertheless, although this study focuses on the first and hence the most challenging year, due to the adoption of a new set of requirements, the extent of disclosure with GAPSME

Degree of disclosure	Distribution of the Disclosure Index	Number of entities	% of entities
High	90% - 100% (0.90 - 1.00)	30	26%
	80% - 89% (0.80 - 0.89)	39	33%
Intermediate	70% - 79% (0.70 - 0.79)	21	18%
	60% - 69% (0.60 - 0.69)	20	17%
Low	50% - 59% (0.50 - 0.59)	3	3%
	40% - 49% (0.40 - 0.49)	3	3%
Major gap	0% - 39% (0.00 - 0.39)	-	-
	Total	**116**	**100%**

Table 3: Distribution of the Disclosure Index

disclosure requirements in 2016 is comparable with that of larger, listed entities in other countries which, as stated above, typically have more resources at their disposal.

The findings also suggest that in compiling their first set of financial statements drawn up in adherence with GAPSME, small private entities referred to the MIA's *Illustrative GAPSME Small Entity Financial Statements* and made use of general, boilerplate clauses with limited tailoring to the specifics of the entities in question. The purpose of the MIA's illustrative financial statements is precisely that of helping entities in the transition to the new set of requirements when preparing their financial statements. Hence, the use of such general clauses ease the burden on small entities, especially in the early years of adoption. Since Malta has now been applying GAPSME for a number of years, an increase in the extent of disclosure from the first-time adoption of GAPSME in 2016 to 2022 or later can be predicted in terms of increased familiarity with GAPSME disclosure requirements. Therefore, increased tailoring of such boilerplate clauses can also be expected to have occurred over time. It would thus be interesting to assess the situation across time by determining the extent of disclosure with GAPSME disclosure requirements prevailing today.

GAPSME Topic	Mean Disclosure Index
Section 5 – Accounting policies, estimates and errors 1. The measurement basis (or bases) used in preparing the financial statements; and 2. The other accounting policies used that are relevant to an understanding of the financial statements.	64% (0.64)
Section 6 – Revenue and construction contracts The accounting policies adopted in relation to the recognition of revenue.	80% (0.80)
Section 7 – Property, plant and equipment 1. The measurement bases used for determining the gross carrying amount; 2. The depreciation methods used; and 3. The useful lives or the depreciation rates used.	80% (0.80)
Section 9 – Financial assets, financial liabilities and equity The accounting policy for each category of financial instrument.	70% (0.70)
Section 10 – Investment in subsidiaries, associates and joint ventures The accounting policy for the entity's investments in subsidiaries, associates and jointly controlled entities.	73% (0.73)
Section 24 – Adoption of GAPSME The date of the transition to GAPSME.	77% (0.77)

Table 4: Distribution of the Disclosure Index by topic

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