

THE CHALLENGES FACED BY SELECTED SRI LANKAN COMPANIES IN THE APPLICATION OF IFRSs FOR SMALL AND MEDIUM ENTERPRISES (SMESs): A CASE STUDY OF HIRDARAMANI GROUP

E. S .Sandamali

H.G.S.Ranasinghe

S.D.R.Wikramanayake

T.N.D.Dilrukshi

H.S.A.D.Fernando

P.L.B.P.B.Guneratne

D.T.M.Fernando

D.H.S.Prathibha

G.G.H.Geethanjalee

A.G.P.S.Abeywickrama

ABSTRACT

As the name suggests, this article “The challenges faced by selected Sri Lankan companies in the application of IFRSs for Small and Medium Enterprises (SMEs): A case study of Hirdaramani Group” is geared to pinpoint the challenges faced by selected Sri Lankan companies in the application of IFRSs for Small and Medium Enterprises (SMEs) and to critically evaluate whether IFRSs for SMEs provide enough guidelines on financial reporting relevant for such companies. In developing a sophisticated analysis throughout the entire article, the flow of the study has been arranged in a chronicle order to develop more sensible discussion. In light of that, this section provides an overview of the structure of the article and a synopsis on each section to be discussed afterwards.

The basis of the study in relation to the research problem has been descriptively elaborated in respect to the current state of the phenomena under the section of “background to the study”. After defining the issue and the objectives, findings of the study will also be summarized under the same section in order to fine tune the pre-determined objectives with the actual results of the study.

To pave the way for a refined evaluation of the current challenges faced by Small and Medium Enterprises (SMEs) in application of IFRSs for Small and Medium Enterprises (SMEs), theory developed by the Accounting fraternity with regard to accounting for SMEs (Small and Medium Enterprises) will be discussed. Mainly literature relating to Financial Performance/Financial stewardship, internal perspective, knowledge and innovation and customer and shareholder perspective will be explored under this section prior developing the evaluation of the actual results with respect to such theory. Findings accumulated through semi structured interviews at research sites on challenges faced by selected Sri Lankan companies in the application of IFRSs for Small and Medium Enterprises (SMEs) in application of IFRSs for Small and Medium Enterprises (SMEs) will be critically evaluated as against the theory discussed in the prior section in order to reach the final conclusion of the study.

KEY WORDS: International Financial Reporting Standards, SME, Sri Lanka Financial Reporting Standards, International Accounting Standard Board

INTRODUCTION

Small and Medium Enterprises (SMEs) play vital role in many countries including Sri Lanka, because of its role for the country's economic growth. SME sector has been identified as a significant strategic sector in the overall policy objectives of the Sri Lankan Government and it is seen as a driver of change for wide-ranging economic growth, regional development, employment generation and poverty reduction.

SMEs make up a large part of Sri Lanka's economy, accounting for 80% of all businesses. These are found in all sectors of the economy, primary, secondary and tertiary and provide employment for persons of different skills, skilled, semi-skilled and unskilled. It is noted that, 20% of industrial establishments fall into the SME group, while in the service sector their share is over 90%. And also SMEs are an essential source of employment opportunities and are estimated to contribute about 35% of employment (Secretariat 2012).

Even though SMEs' contribution to the Sri Lankan economy is high, from the perspective of financial reporting SMEs only produce and maintain financial statements only for the use of owners and internal parties or only for the use of tax authorities and government (IFRS Foundation, 2011). SMEs often encounter accounting and financial management challenges due to poor record keeping.

It has been recognized that appropriate accounting information is important for successful management of any business entity, whether large or small. It is crucial therefore that the accounting practices of SMEs supply complete and relevant financial information needed to improve economic decisions made by entrepreneurs.

The most of the SMEs do not keep complete accounting records because lack of accounting knowledge and the cost of hiring professional accountants. As a result, there is an inefficient use of accounting information to support financial performance measurement by SMEs. This made it difficult for the entrepreneurs to calculate their business profit efficiently. Therefore, prudent financial reporting practices is paramount important for the wellbeing of SMEs and to strengthen their economic and social contribution.

The shortfalls in accounting process of SMEs might result in difficulties in succeeding and raising funds or borrowing money. The shortage of capital due to number of reasons such as lack of access to bank facilities, lack of knowledge of bank procedures, long delays in obtaining credit and inability to provide guarantees are major problems faced by the SMEs. To overcome the difficulties faced by the SMEs when preparing accounts, Sri Lankan Accounting standards for SMEs could be interpreted as a set of simplified, tailor made and self-contained accounting and reporting standards which are compatible with the capabilities of Small and medium sized entities.

But there are several obstacles encountered in implementing these tailor made simplified standards for SMEs. As a major consequence of this endeavor accounting profession as a whole also faces the challenge of defining and setting the criteria for defining small and medium sized entities and outlining its boundaries. (Dasanayaka, 2009) Moreover there are other challenges such as difficulty in providing adequate training and skills to SMEs regarding practice and application of the standards. (Lekhanya, 2013) In light of that this proposed study attempts to identify and analyze present and potential challenges of application of SME standards on Selected Sri Lankan SMEs.

PROBLEM STATEMENT AND RESEARCH QUESTIONS

Overview

Small and Medium sized entities (SMEs) in an economy plays a vital role in maintaining market stability, because it is very crucial to ensure full employment and promoting sustainable development. It is a well-accepted fact that financial reporting in SMEs is a major function of those companies and would be used as the main performance evaluation tool for the stakeholders.

It is a commonly accepted phenomenon that no single set of financial reporting requirements is appropriate for all types of business entities .Because in the context of “Small and Medium-Sized Entities” (SME) prior to introduction of IFRS for SMEs; they had to comply substantially with the same requirements as other companies in the industry even if there is no practical requirement of that.

In addressing this issue, IFRS for SMEs, International Financial Reporting Standard for Small and Medium-Sized Entities, was issued by the International Accounting Standards Board (IASB) in 2009. The studies which have already been done substantially focused on how SMEs would be benefited by adoption of IFRS for SMEs rather than the full standard. As per the study done by the Institute of

Chartered Accountants of Sri Lanka has emphasized on this while highlighting the importance of introducing IFRS for SME that SMEs are having an undue cost burden of reporting, which is proportionately heavier for smaller firms deterring flexibility of SMEs. Further Deloitte partner D.J.Gannon states that SMEs still have considerable threats but not specified what the treats are.

Even though it is evident from the literature that many research have been conducted on this area of study, relatively low prominence has been placed on the challenges faced, Even if the challenges were pinpointed, there was no proper conclusion. Hence this study makes an attempt to bridge this gap and tries to discover the challenges faced by the SMEs when applying IFRS for SMEs and arrive at a proper conclusion. In light of this, below research questions have been addressed from research.

Research questions

1. What are the challenges faced when applying IFRS for SME?
2. Does IFRSs for SMEs provide enough guidelines on financial reporting relevant for Small and Medium Entities?
3. Does IFRSs for SMEs provide the relevant and reliable information and whether these IFRSs for SMEs provide better accounting picture compared to full IFRS

OBJECTIVES OF THE STUDY

Main Objective

Access to finance is one of the biggest challenges SMEs face, and due to this, they have difficulty to sustaining the business resulting in more than 40% of SMEs ceasing to exist within ten years of operation.

There for clear set of standards for SMEs is very important, as it addresses a range of underlying issues including how to overcome the current situation where SMEs fail to produce reliable financial statements, because most of them maintain financial records in a very informal manner. It is believe that if these SMEs put in place processes to keep accurate financial records and produce reliable financial statements as per the required standards, a significant portion of the battle to access finance is won.

Mr. Sanath Fernando, who is a member of the Implementation Group of IFRS for SMEs, the advisory body to IASB on SME financial reporting emphasized that the Sri Lanka Financial Reporting Standard for SMEs is good financial reporting made simple and any entity that does not have public accountability, no matter the size of the organization, can adopt it.

Even though CA Sri Lanka adopted the IFRS for SMEs from 2012, still we can see non compliances with those standards in real working environment. *Therefore our main objective is to identify the challenges faced by selected Sri Lankan companies in the application of IFRSs for Small and Medium Enterprises (SMEs).*

Specific Aims

- To analyze whether SME standards provide enough guidelines to the financial reporting of those small and medium sector companies.
- Whether those SME standards provide the relevant and reliable information and provide a better accounting picture of those entities rather than using of IFRSs.

The main output of this research project is expected to be a discussion Paper that includes a comprehensive overview of the challenges of the SME standards. And also it helps to evaluate the current accounting standards and applications.

LITERATURE REVIEW

Small and Medium Entities by its wordings refer to micro, small and medium enterprises which are defined differently by different countries based on the contextual situation persistent in that particular country. As per Storey, 1994 acceptable definition of SME firm is not possible and there is no single, uniformly accepted definition of a 'small firms'.

In the Sri Lankan context, the Ministry of Industry of Commerce have specifically mentioned in the National Policy Framework for Small and Medium Enterprise (SME) Development that the Small Medium Enterprise (SME) sector represents an important strategic sector in the overall policy objectives of the Government of Sri Lanka (GOSL) and it is seen as a driver of change for inclusive economic growth, regional development, employment generation and poverty reduction.

Small and Medium Entities are considered as one of the main driving forces of economic development because they generate new employments, introduce new business methods and products, reduce poverty, inflation and income inequality and solve the balance of payment problem (Prasad, Tata and Guo, 2012; Singh, Garg and Deshmukh, 2010; Tambunan, 2008; Zeinalnezhad, Mukhtar and Sahran, 2011).

Like for large scale enterprises, the accounting for SMEs in Sri Lanka is regulated by the Institute of Chartered Accountants of Sri Lanka (ICASL). As per IASB in 2016 entities which meet the definition of SMEs can apply either full set of IFRS or IFRs for SMEs but the IASB also makes it clear that the capital markets are the prime users of IFRSs. This leads to create a doubt in the minds of people whether the IFRSs are primarily designed for quoted companies and not SMEs.

The Institute of Chartered Accountants of Sri Lanka too have identified that the general set of accounting standards are not applicable to all entities, especially SMEs. On these grounds ACCA Global have created an argument that a vast majority of the world's companies are small and privately owned, and the IFRSs are not relevant to their needs or to their users. {ACCA and ECSAFA [Easter Central and Southern African Federation of Accountants] (August, 2007)}.

Moreover they also emphasize on the undue cost burden of reporting, which is proportionately heavier for smaller firms deterring flexibility of SMEs. This is because SMEs in general have fewer available resources for financial reporting compared with listed entities.

Deloitte partner D.J.Gannon states that some private companies are still not aware of IASB's efforts in addressing the needs of private companies. Thus it can be seen that despite of the perceived benefits, IFRS for SMEs still have considerable constraints in meeting the needs of SMEs.

Poroy & Sipahi (2007) notes that the transition to IFRS for SMEs will be difficult because of the low corporate level of SMEs and the differences between tax legislation and IFRS for SMEs. The question of whether the IFRS for SMEs will be suitable for the smaller entities within the SME arena has been raised by Roberts and Sian (2006) in their paper entitled "Micro-entity Financial Reporting: Perspectives of Preparers and Users".

Challenges of applying SME Standards in the Sri Lankan context can be viewed in the perspectives of preparers of financial statements and users of financial statements. Most small entities in developing countries maintain accounting records of some description with the limited financial expertise compared to developed countries. So main concerns of owners of SMEs are on the cost of producing the statements along with the ability to understand those financial statements prepared based on applicable standards.

As identified by the existing literature, the main users of financial statements of SME are Directors, Banks and Tax authorities. International Federation of Accountants have described the aims of these users

precisely where the directors utilize these reports in order to monitor performance and to assess the returns and risks whereas the banks or financial institutions assess the credibility or ability to repay through these financial statements.

Most of the instances SMEs prepare financial statements only for Income tax purposes. Countries such as Lebanon, Slovakia, Austria, and Russia believe that SMEs favour preparing financial statements for tax purposes only (IFRS Foundation, 2011)

Irvine and Lucas (2006) cite lack of accounting education and training as one of the challenges SMEs face in adopting the standard. Lekhanya (2013) is also with the mind-set that people working in rural SMEs in KZN (Kwazulu-Natal), including business owners/managers do not have accounting and financial management skills.

Arjuna Herath, President, CA Sri Lanka, have also commented in the CA Sri Lanka Press Room article named SME Friendly Accounting Standard Contemplated (2014), *“That there is a specific standard applicable to SMEs. However, some of these companies considering compliance with the SME standard or those in the process of adopting the standard have cited few technical accounting difficulties. Many of these difficulties arise out of the fact some of the principles in the standards do not apply to specific peculiar context or circumstances”*.

As discussed earlier SMEs is considered as major economic players and as potential sources of national, regional and local economic growth (Taylor and Murphy, 2004). SMEs differ from large companies in important ways affecting their information-seeking practices (Buonanno et al., 2005). Hence, a question arises on whether SMEs can be treated as miniaturized versions of larger organizations or whether it should be treated differently with more attention.

Samujh and Devi (2015) are in the view that the IFRS for SMEs are not appropriate for ASEAN countries. What they argue that instead of aiding SMEs economic growth, IFRS for SMEs may create a burden to growth through unnecessary imposition of financial reporting and regulatory requirements which inadvertently may result in reduced entrepreneurship activity. So it is understood that SMEs should be dealt with care and the financial reporting applicable to them should be developed carefully in order to reap best from them rather than making them frustrated.

As a response for the international demand from developed and emerging economies for common set of accounting standards for SMEs, these IFRSs for SMEs have been developed. They are considered to be much simpler than the full IFRSs fitting the simplified reporting needs of SMEs. Based on those findings and existing literature review pinpointing the different standpoints it was salient that IFRS for SMEs are a burden and too difficult for some SMEs to adopt.

RESEARCH METHODOLOGY

Research Methodology aims to specify the types of methods selected for data collection and analysis and the reasons for why these methods were chosen in comparison to the other alternative methods.

The purpose of this research is to provide evidence on the Research on challenges faced in the application of IFRSs for Small and Medium Enterprises (SMEs): A case study of Hirdaramani group over their accounting treatment. We have selected the qualitative research approach to achieve these research objectives. Accordingly the research was conducted by means of self-administered questionnaire based interviews which was distributed to Accountants and Accounts Executives of the Hirdaramani Group. Questionnaire is a common place instrument for observing data beyond the physical reach of the observer.

To achieve our objective, first we got a thorough understanding on IFRS for SMEs then the views on complexity of Standards and contradictory areas Standards. Finally we identified critical challenges in Accounting based on IFRS for SMEs.

Sample Selection

Population consist the Sri Lankan SME sector companies which apply IFRS for SMEs in their financial reporting .Out of the total population we have selected the Hirdaramani Group consisting 15 companies based on the qualitative (Purposive sampling approach) criteria. Study sample was the accountants or any other personnel who is having good accounting knowledge in the selected companies.

Data and Collection Instruments

This study used both primary and secondary data. Primary sources of data include interview and questionnaire, whereas secondary sources data was generated through a review of relevant documents. We interview 23 Accountant and Accounts Executives in Hirdaramani Group.

Questionnaire

Questionnaires were distributed to accountants and Accounts executives of the Hirdaramani Group and these personnel were selected as respondents because they are deemed to be knowledgeable about challenges faced in the application of IFRSs for SMEs. Their responses assisted us in understanding the factors that create the challenges they face in the application of IFRSs for SMEs by Hirdaramani Group

Hirdaramani Group adopted IFRSs in 2002. The research evidence was gathered by using both close-ended and open-ended questions. Mixed types of a questionnaire has been selected due to its many merits; the most important of this advantage is its considerable flexibility.

The questionnaires were extracted from Fikru Fantahun Tesfu (2012) as it is an already tested questionnaire on this issue. With regard to the close-ended questions, the respondents were asked to indicate their level of agreement on a five point Likert scale. With respect to the open ended questions, the respondents were asked to provide open ended responses to the questions that require opinion that they feel the researcher would find useful.

Interview

Semi structured interview with Accountants and Assistant Accountants of the Hirdaramani Group were conducted. It allowed us some degree of flexibility at the time of interviewing for the pursuit of unexpected line of inquiry which was arising at the study progresses. Questions in the interview checklist were constructed based on the existing literature that we went through.

In the process of preparing, testing and using the instruments, the following procedures have been followed.

- i. The questionnaires and the interview guides were developed based on literature review relevant to the issue and the specific objectives.
- ii. Both tools were judged for their validity using professionals in the area.
- iii. In the final study, the questionnaires and interview were administered both by the researcher and assistants.

Document Review

The review of documents helped us to understand the key facts of the organizations. The documents were reviewed by referring most recent information from authorized documents and different reports. Audit

Documents and other documents related to the adoption and use of IFRSs for SMEs were used. The document reviews were used to triangulate the data collected by the questionnaires and interviews.

Theoretical Framework

To explore, describe, explain, analyze and present fact, principle and provisions of the selected topic for better and background understanding Fikru Fantahun Tesfu (2012) research article was used as theoretical framework.

Based on its theoretical aspect our study was structured use the dependent variable as the application of IFRS for SMEs, while the independent variables as the challenges they face while in the application process.

ANALYSIS AND DISCUSSION

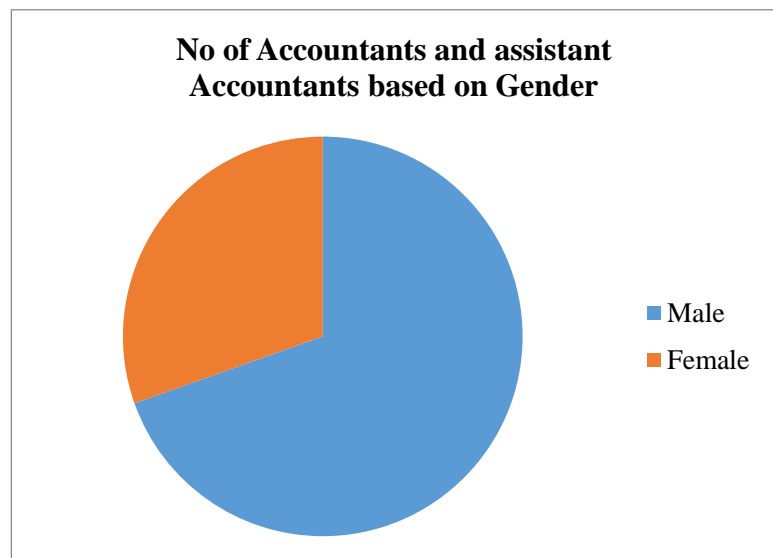
In this section the results that were obtained from semi structured interviewing will be evaluated in a broader sense in relation to the common questionnaire that were used as a guide while interviewing

Section 1: Demographic Background

1.1 Number of Accountants and Assistant Accounts based on Gender

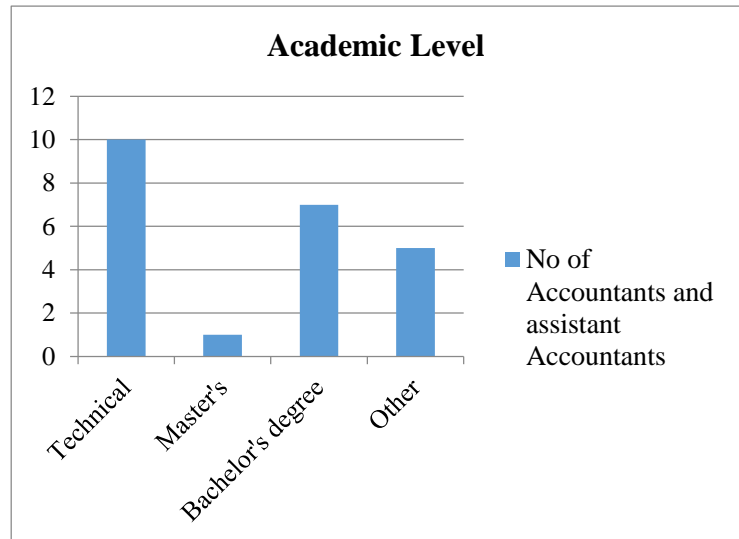
Gender	No of Accountants and assistant Accountants
Male	16
Female	7
Total	23

16 Male and 7 Female Accountant and Accounts Executives were interviewed from Hirdaramani Group.



1.2 Number of Accountants and Assistant Accountants based on Academic Level

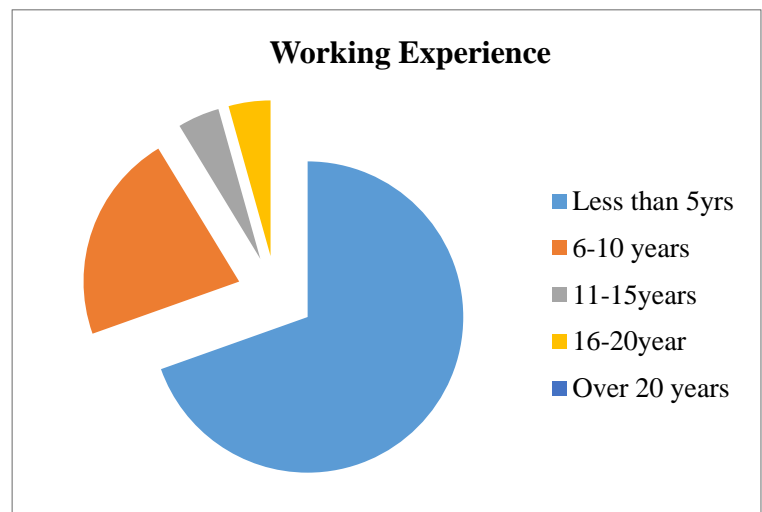
Academic level	No of Accountants and assistant Accountants
Technical	10
Master's	1
Bachelor's degree	7
Other	5
Total	22



Based on our data gathered, most of Accountants and Assistant Accountants have Technical Skills and among others seven people have Bachelor's Degree, four people have CIMA Qualification and one of the Accountant has a Master Degree.

1.3 Number of Accountants and Assistant Accountants based on Working Experience

Working Experience	No of Accountants and assistant Accountants
Less than 5yrs	16
6-10 years	5
11-15years	1
16-20year	1
Over 20 years	0
Total	23



Based on our questionnaire based interviews that were carried out most of the Accountants and Assistant Accountant have less than five years Working Experience.

1.4 Number of Accountants and Assistant Accountants based on Current Position in the Organization

Position	Number
Accountants	15
Assistant Accountants	8



Among the personnel that were interviewed there were 15 Accountants and 8 Assistant Accountants from the Hirdaramani Group.

Section 02: Adoption and practices of International Financial Reporting standards (IFRS) for SMEs in your company

2.1 When did your company start using for SMEs? / 2.2 what reporting standards previously used?

Shortly after its inception in 2001, the IASB started a project to consider reporting for Small and Medium-size Entities. As a result of that IFRSs for SME was issued in July 2009. According to the responses given by the selected accounting professionals who are working in the SME sector, 74% of responses have start using IFRS for SMEs in 2012/13 although it had been introduced in 2009.

As well as, our research reveals that most of the companies (61%) had previously used the LKAS as their reporting standard, which is mainly due to the easy comparison with the industry. And others had been using the SLAS as the reporting entity.

2.3 / 2.4 Comparison of previous standard to the IFRS for SMEs

Based on the information which we have gathered through our sample, 90% of responded are preferred to use the IFRS for SME compared to the previous standard used by them. Because, The IFRS for SMEs responds to strong international demand from both developed and emerging economics for a rigorous and common set of accounting standards for smaller and medium sized businesses that is much simpler than full IFRSs. The IFRS for SME will also provide a platform for growing businesses that are preparing to

enter public capital markets, full IFRS is required. In precise, the IFRS for SMEs will provide an improved comparability for uses of accounts, enhance the overall confidence in the accounts of SMEs and reduce the significant cost involved of maintaining standards on a national basis. Below is quoted from the interview conducted which provides a comparison of IT infrastructure in standard implementation.

“We don’t have much IT infrastructure to support full IFRSs. Yet our systems fully support and integrate with IFRSs for SMEs”

Section 3: Factors that could affect the Adoption of IFRS for SMEs by Sri Lankan SME companies and the benefits and challenges of adopting it.

A. Factors affecting IFRS for SMEs adoption

According to studies carried out by many researchers it was salient that Small and medium size enterprises (SMEs) tend to prepare its financial statements mainly for the statutory purposes such as tax purpose, bank purpose and review of the purpose. Simply it seems that SMEs primarily use financials for external purposes rather than internal purpose. In this study, four main factors consider in evaluating the degree of influence in adoption of SLFRS’s for SMEs are Government policies, Company size, Education level and other factors such as professional support with SLFRS for SMEs, Financial statements based on IFRS for SMEs are reliable and comparable etc

Government policy

Harmonization of accounting standards under the lead of International Financial Reporting Standards (IFRS) is becoming trend among countries because of the comparability advantages it provides for countries and multinational companies. When conducting semi structured interview majority of the accountants from Hirdaramani agreed that Sri Lankan government encourages SMEs to adopt IFRSs for SMEs. They stated that tax regulations are influence them on preparation of financial statements. Here we interview 23 professionals from Hirdaramani Group of Companies and 57% in the view that government policies are influence the adoption of IFRSs for SMEs.

Whereas they has no politics influence on adopting IFRS for SMEs. In nutshell Government policy has high degree of influence in adoption of IFRSs for SMEs rather than the politics. Many Responses are in the view that politics are less relevance in deciding whether adoption of IFRSs for SMEs.

Company Size and Size of the Capital

Due to harmonization of accounting standards it would be easy for investors to evaluate potential investments in foreign securities and foreign companies. Therefore size of the company would mainly

affect in determination of adopting IFRSs for SMEs. According to the IASB one of the main benefits of global financial reporting standards is the enhanced comparability of financial information or the improved efficiency of capital allocation and pricing. Here Company size refers in terms of assets and liquidity and Capital market here is referred to a market for securities (debt or equity), where business enterprises and governments can raise long term funds.

When interviewing 74% of accounting professionals from Hirdaramani expressed that size of the capital and size of the company lead to decide in adoption of IFRS for SMEs. Here since Hirdaramani is group of companies they in the view that size of the company is main consideration in adopting IFRSs for SMEs.

Respond	Size of Capital		Size of Company	
Agree	17	74%	17	74%
Disagree	1	4%	2	9%
Neutral	2	9%	3	13%
Strongly Agree	3	13%	1	4%

Educational level

As demonstrated below most of the accountants expressed that propound level of knowledge and trained peoples are need in adoption of IFRSs for SME. And more over nineteen peoples out of 23 accountants considered weak level of education as barrier to implement IFRSs for SMEs and more than 85% believe that having trained people in the place greatly influence in adopting IFRS for SMEs. However they in the opinion that Education and training requirement for IFRSs for SMEs is much less than adopting full IFRS. Below mentioned was quoted from the interview (Quoted from the explanation of one of the accountants) conducted with regard to the educational level.

“We are conducting an internal training for every six month period. In addition to that we send an employee/s for every training session conducted by Institute of Chartered Accountants (ICASL) in the meantime we sponsor for the courses offered by the institute”

Other Factors

Information to owners, managers and the calculation of taxable income are the major objectives of financial statements in SMEs. Therefore high degree of respondents from Hirdaramani believed that their objectives were achieved by adopting IFRSs for SMEs.

SMEs mainly reported their financials to its owners and since they have limited number of stakeholders they in the view that financial statements prepared under IFRSs for SMEs sufficient enough to improve effectiveness and efficiency of financial reporting.

When interviewing more than 60% of respondents mentioned that adoption of IFRSs for SMEs is costly. SMEs have either to follow the reference to the full IFRS (if required) or applying the IFRSs for SMEs. Both alternatives can provoke considerable costs which might justify the inclusion of an explicit simplified regulation in the IFRSs for SMEs. Although it is not possible to them to counterbalance costs and benefits.

However Hirdaramani adopt IFRSs for SMEs since it is less costly when compared with full IFRSs and Since Hirdaramani is not listed in Capital market they are not supposed to provide their financials to public. Therefore they don't have any idea of move into full IFRSs from IFRSs for SMEs.

Moreover have limited professional support from the professional bodies such as the Institute of chartered Accountants in Sri Lanka (ICASL) on the matters they encountered.

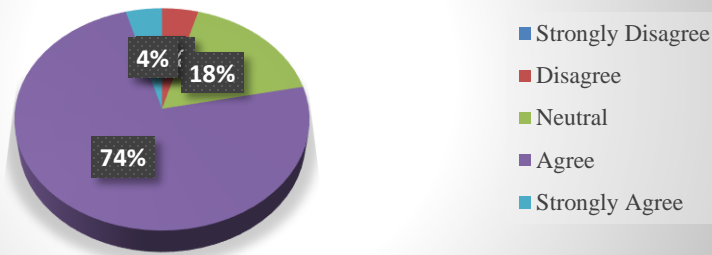
B. Challenges of IFRS Adoption

Though the semi structured interviews we have obtained the responses from 23 persons who are actively involving to the financial reporting process in the Hirdaramani Group of companies. In this section we are focusing on the challenges faced by SMEs when applying IFRSs for SMEs. As the guidance for the interview we used questionnaires. Following challenges can be listed down with their responses got from the sample study.

✓ Adoption of IFRSs for SMEs is costly

When implementing the financial reporting process based on the IFRSs for SMEs, it requires lot of money at the initial stage of implementation. Most of the costs were incurred due to the consultancy cost and for the implementation cost. Earnest and Young chartered accountants provide consultancy services for the maintenance of financial reporting process as they are specialize in the particular industry where they are negotiating high consultancy fee. Responses taken from the personals can be drawn in the diagrams as follows.

Adoption of IFRS for SMEs is costly



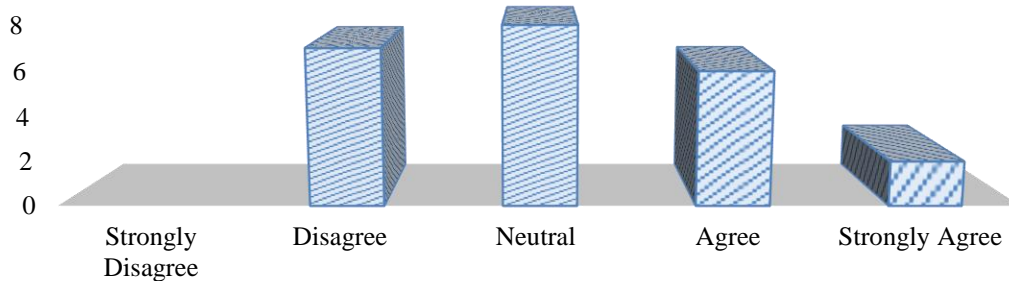
Out of the total interviewees 74% of respondents were agreed adoption to IFRS for SMEs as a costly process. Some respondents were strongly agree and neutral for the raised challenge and they are having the proportion of 4% and 18% respectively. Only one person has disagreed with the statement. As an overall conclusion Adoption to the IFRS for SMEs is a very costly process.

✓ IFRS for SMEs increases the complexity of financial reporting

Sometimes companies may hesitate to adapt to IFRS for SMEs due to the existence of the suspicious on the complexity of the financial reporting. During this study we compelled to take this as challenge and sort out the doubt. Following graph depicts the results obtained on the enlightened challenge.

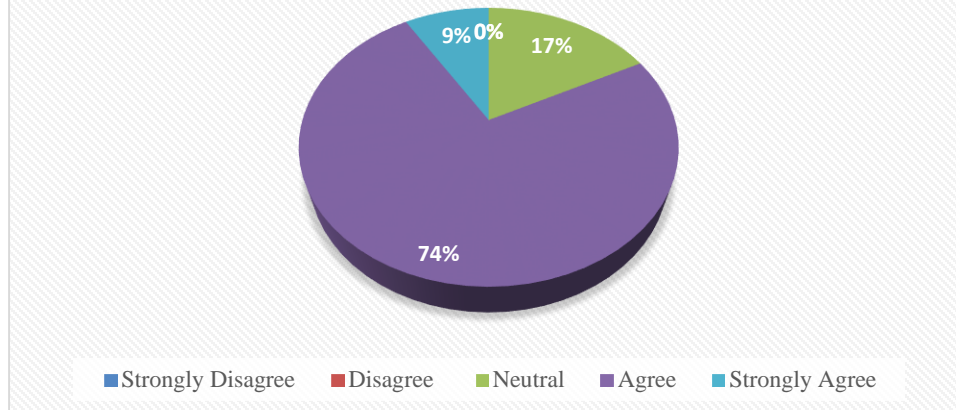
In the bellow graph, Majority of interviews are having a compliance by expressing their responses and strongly agree and agree with the enhanced challenge and they are representing 9% and 26%. Same percentage of respondents are neutral having 35% of percentage. 30% of respondents are disagreeing with the statement. Finally it can be concluded that they are recognizing complexity as a challenge adapting to IFRS for SMEs.

IFRS for SMEs increases the complexity of financial reporting.



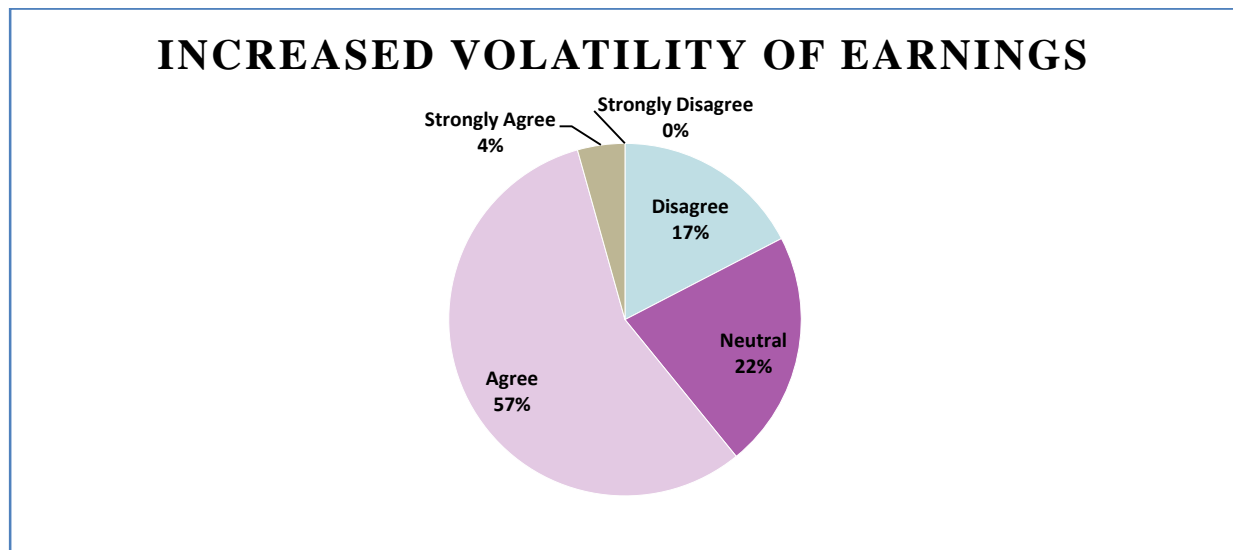
✓ There is a lack of IFRS for SMEs implementation guidance

Lack of implementation guidance on IFRS for SMEs



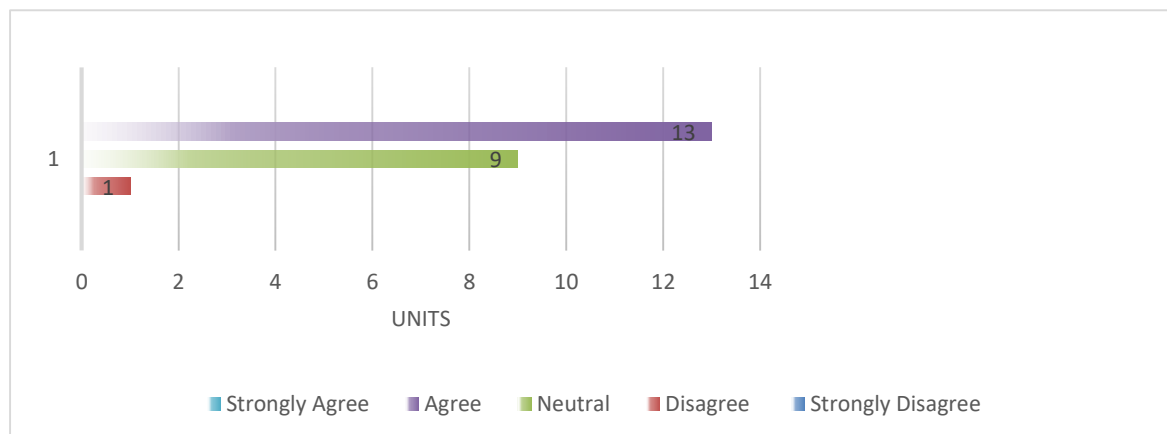
As other challenge of adoption to IFRS would be the lack of guidance for the implementation of IFRS for SMEs. Though there are so many professional bodies are available currently some companies may not be guided on IFRSs by those institutions. Consequently they used to take advices from consultants who are providing consultancy services at the high rates. In the context of Hirdaramani, they have been guided by Ernest and Young IFRS unites where they have to pay considerable consultancy fee. When looking at the results obtained through the interviews we were able to identify 74 % and 9% of respondents who were agreed and strongly agreed respectively to the statement emphasized.

✓ **IFRS for SMEs brings about increased volatility of Earnings**



In this question, we focused on value addition gained by the company through the adoption of the IFRS for SMEs. Based on the responses obtained it can be seen that 57% has agreed to that through the IFRS they are earning value addition to the company and 4% strongly agreed. There is 17% of disagreement over the value addition to the company. However the balance respondents are neutral on their expression.

✓ **Tax driven nature of previous standards is a challenge for IFRS for SMEs adoption**

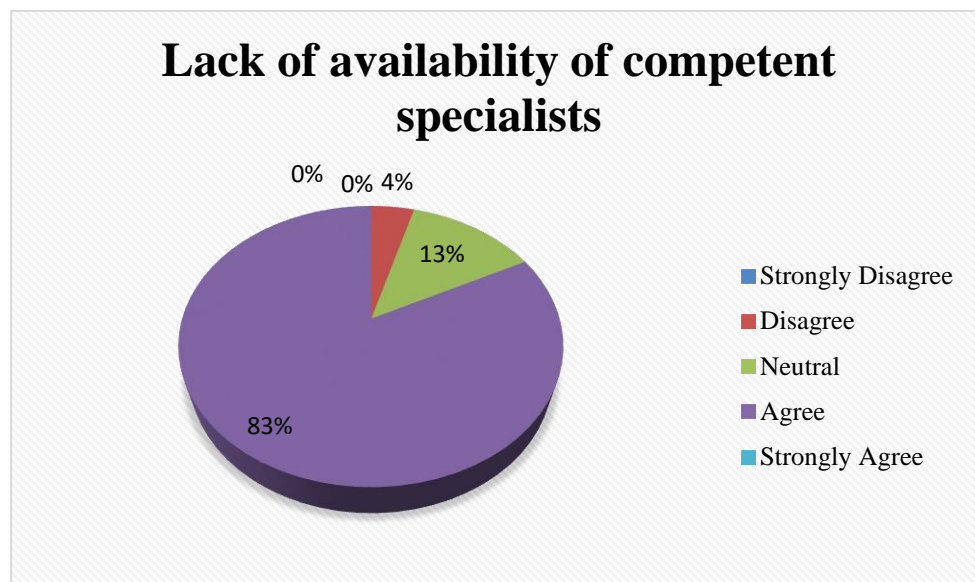


Most of the small and medium enterprises are adapting to some frameworks due to requirement of Inland Revenue department where they are tax liable on their profit earned during the particular year. But such kind of tax driven nature of standards may become as barriers for its adoption. Because complying with number of frame work may not pay the way to operate their financial reporting process effectively and

efficiently. As per the above graph 57% of respondents are neutral with the statement while 39% is disagreeing with the same.

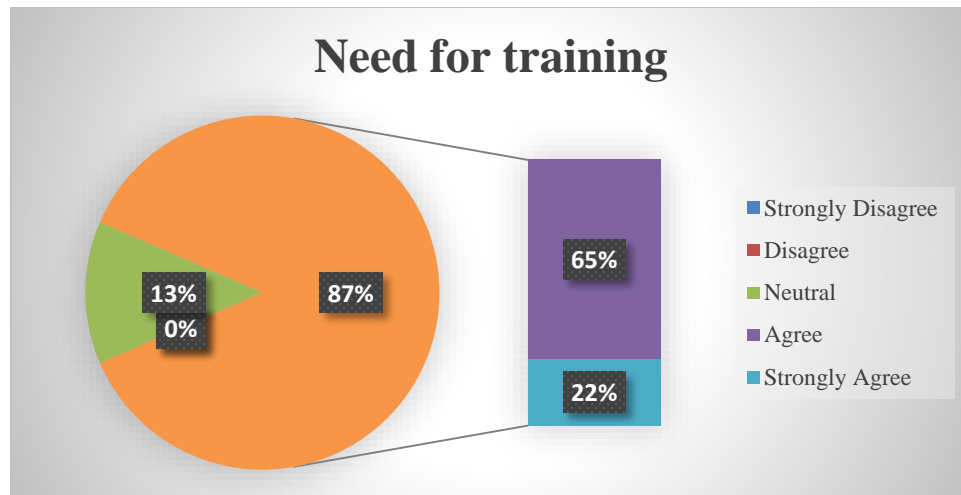
✓ **Lack of availability of competent specialists**

Without having experienced knowledgeable specialists on the implementation process it will be very hard to get succeed .One of the critical challenge faced by SMEs is these types of matters. They have to dedicate their valuable time well as money to find out the proper specialist for their financial reporting process. This is proved through our research, as there are an 83% of agreements while only having 4% of disagreements.



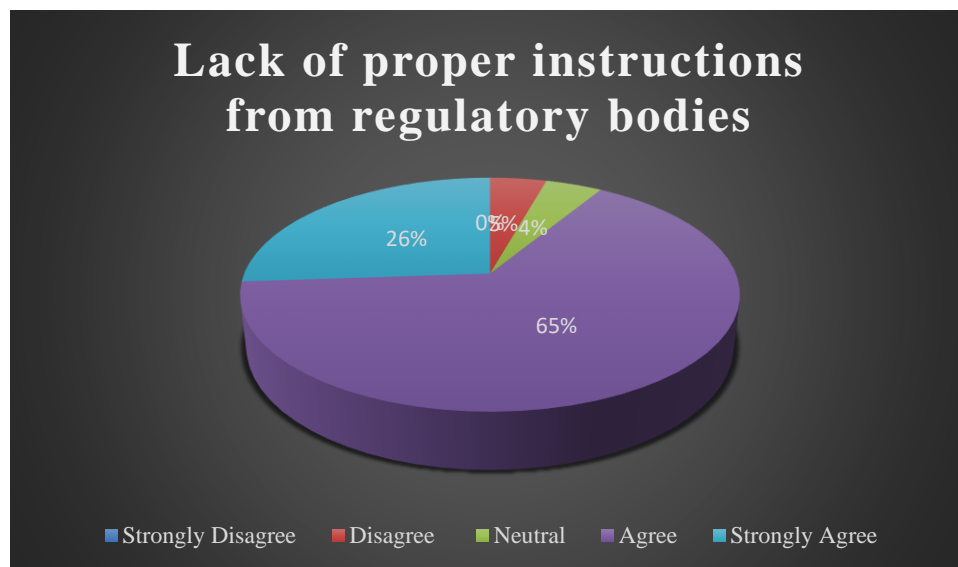
✓ **Need for training**

In order to adapt to new frame work finance staff should be properly trained. Otherwise it will not be worked as they intended .To get the maximum benefit out of it company has to train their staff .And also there are some updating maters available time to time .consequently staff will be trained continuously which may incur cost to the company. In Hirdaramani, they have used to conduct in house training sessions on financial reporting process and out bound trainings which are organized by some professional institutions and regulatory bodies (e.g. Inland Revenue Department). As per below graph 87% says that there should be need for training where 13% having neutral with the need.



✓ **Lack of proper instructions from regulatory bodies**

Regulatory bodies are not instructing SMEs properly. For an instant Institute of Chartered Accountancy does not provide enough guidance to them though they are the one of regulator in setting financial frame works. And also there are time to time changes in accounting frameworks where those bodies should make aware of others. Following graph depicts that 91% of respondents are expressing that they are not offered enough guidance from the regulatory bodies.



✓ **Problem with the IT system in handling the transition to IFRS for SMEs**

Out of 23 interviewees most of them said adoption of IFRS for SMEs is costly and more difficult due to problem with the IT system in handling the transition to IFRS for SMEs. Because this created additional

cost to them for make changes to existing system and trained their employees to new system. The respondents also believe that lack of availability of competent IT specialists, and IT system in handling the transition to IFRS for SMEs, increased the IT transition cost of the company.

✓ **Problem with IFRS for SMEs use of fair value accounting**

Another challenge of adopting IFRS for SMEs can arise due to its emphasis on fair value accounting. Most of the interview respondents believe that the use of fair value accounting instead of historical cost is another challenge in adopting the IFRS for SMEs. Similarly, the interview result reveals that since the fair value accounting incorporates more information into the financial statements than historical costs it is a major challenge for Private small and medium business such as Hirdaramani. Due to some conditions are in fair value accounting not favorable for implementing IFRS for SMEs such as achieving observable market prices and accurate estimates of liquid market prices increases the complexity of financial reporting.

✓ **Lack of clear and coherent accounting practices application**

Nearly half of the interviewees have the opinion that a major source of the difficulties regarding the technical aspects of the application of IFRS for SMEs is the lack of clear and coherent accounting practices application. According to the interview results this lack of coherent accounting practices application creates risks for comparison and interpretations of financial statements and increases the risk for manipulation in interpretation of financial statements. Below was quoted from the interview held with regard to the fact of preciseness of details.

“Proper guidance is not given regarding accounting estimates. So we have to rely on our consultants to determine the bases of certain estimates”

✓ **Insufficient reference materials for the guidance of accounting process.**

The respondents also believe that lack of availability of reference materials, lack of proper instructions from regulatory bodies for guidance of accounting process of SME will create problems to adoption of IFRS for SMEs. The interview result revealed that lack of specialists who could assist by providing reliable answers to SME accounting practices create major challenge in implementing IFRS for SMEs.

✓ **Lack of practical knowledge to convert current practices in to IFRS for SMEs**

Most of the interviewees (Nearly 74%) have the opinion that due to the complexity and less understandable nature of IFRS for SMEs standard requires a double workload during the transition year for finance and accounting people and many others. This results in not only increased internal employee cost but also external monitoring costs such as high audit fees. A training program for staff across the company is also another costly investment and of course one of the most important factors that increase the adoption of IFRS for SMEs.

✓ **Weak advocacy by the local institute of Accountants has also made a challenge for the application of IFRS for SMEs.**

Not more but few respondents have the opinion that there is a weak advocacy of the local institute of Accountants has also made a challenge for the application of IFRS for SMEs. But nearly 40% of respondents have the opinion that Institute of Chartered Accountant of Sri Lanka (CA Sri Lanka) plays a good role as an intermediary to solve the challengers by conducting seminars and other consulting programs. Below was quoted from the interview regarding the perception that the group holds on role of ICASL as a facilitator and an intermediary.

“The role of Chartered institute as an intermediary in the process of IFRSs for SME implementation is not satisfactory as per our judgment”

✓ **IFRS for SMEs does not provide the solution for the accounting issues at any time which may pave the way to go for a another accounting frame work**

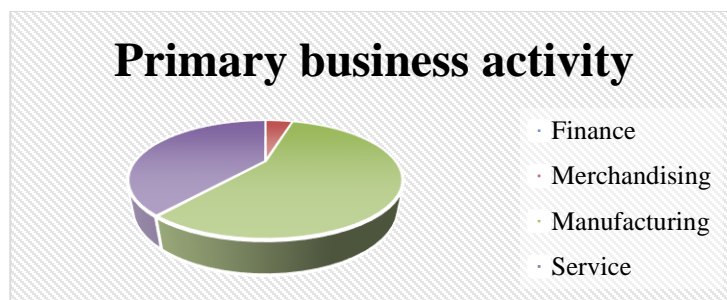
Nearly 52% of the interviewees with the opinion to go for another accounting frame work due to above difficulties. But other 48% respondents have the opinion that only few amendments required to current IFRS for SME standards without going for another frame work.

Section 04: Company profile

4.1 Primary activity of the business

Out of 23 interviewees 13 were from the manufacturing companies. It represent the 57% of the sample. Further, 39% and 4% represent the Service organizations and Merchandising respectively.

Finance	0%
Merchandising	4%
Manufacturing	57%
Service	39%



4.2 Capital of the company

According to our analysis, all the companies we have selected as the sample of our research is financially strong companies. Because, the capital of such company is over 1.5 million at the date we gathered information.

CONCLUSION

According to the data which have gathered and the analysis of the that data evident that the government policy, training and knowledge level, size of the company and the capital are the factors which have the greatest influence to the adaptation of IFRSs for SMEs. Respondents of the study have agreed to the challenges that we have highlighted in the questionnaire. Out of the total interviewees 74% of respondents were agreed adoption to IFRS for SMEs as a costly process. As other challenge of adoption to IFRS would be the lack of guidance for the implementation of IFRS for SMEs. Therefore higher amount of agreed respondents was proved that fact. Without having experienced knowledgeable specialists on the implementation process it will be very hard to get succeed. This is proved through our research, as there are higher rate (83%) of agreements on that issue. More than 90% of respondents are expressing that they are not offered enough guidance from the regulatory bodies. Most of the interviewees have the opinion that a major source of the difficulties regarding the technical aspects of the application of IFRS for SMEs is the lack of clear and coherent accounting practices application. Same as that they have the opinion that due to the complexity and less understandable nature of IFRS for SMEs standard requires a double workload during the transition year for finance and accounting people and many others.

Therefore the results of this research has highlighted that there are many challenges on application of the IFRSs for SMEs. Specially the cost and the lack of proper guidance, complexity are the major challenges among that. Even though there are so many professional bodies are available currently some companies may not be guided on IFRSs by those institutions. As a result of that they used to take advices from the outside consultants and it make another burden to those companies.

The main objective of the implementation of IFRSs for SMEs are to make objective and clear financial reporting in SME sector and the less cost and less complicated financial reporting platform to those companies than use of full set of IFRSs. Therefore it is questionable whether the IFRSs for SMEs are capable to achieve those targeted objectives. Because sometimes it make overburden to those companies. Therefore the factors of those results highlighted the requirement of changing the application of IFRSs for SMEs. Especially the accounting professional bodies in Sri Lanka have to make considerable involvement on this issue. It is better to evaluate the effectiveness of current accounting practices under the IFRSs for SMEs and provide enough guidelines for the application. Especially the lot of application challenges of IFRSs for SMES are emergent new accounting standards or practices for Small and medium enterprises for the better improvement of financial reporting.

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APPENDICES

Appendix 1: Details of selected sample

Company Name	Accountant/Contact Person
1. CKT Apparel (Pvt) Ltd	Mr.Anuranga Wijethilaka
2. Hi fashion (Pvt) Ltd	Mr.Amila Sarathchandra
3. Hirdaramani Fashios (Pvt) Ltd	Mr.Priyantha
4. Hirdaramani garments Katunayake	Mr.Manoj Pushpakumara
5. Woven Cluster (Pvt) Ltd	Mr.Nimal Waragoda
6. Knit Cluster (pvt) Ltd	Mr.Manoj Pushpakumara
7. Hirdaramani industries (Pvt) Ltd	Mr.Milinda Bombuwala
1. Hirdaramani mercury apparel (Pvt) Ltd	Mr.Manoj Pushpakumara
2. Hirdaramani (Pvt) Ltd	Mr.Senaka Chathuranga
3. Ethiopia (Pvt) Ltd	Mrs.Achini Wijemuni (Assistant Accountant)
4. Ceylon Knit Trend (Pvt) Ltd	Mr.Anuranga Wijethilaka
5. Hirdaramani clothing (Pvt) Ltd	Mr.Dashika Gunawardena
6. .Nidro Suppliers (Pvt) Ltd	Accountant
7. COLMO (Pvt) Ltd	Ms.Dilini Gunawardane
8. NIMO and company (Pvt) Ltd	Accountant
9. ILMA Educational foundation	Mrs.Nadeeshika Amarasinghe
10. 247 Techies (Pvt) Ltd	Mr.Indicab (Assistant Accountant)
11. Eureka Technology Partners (Pvt) Ltd	Accountant
12. Jinasena (Pvt) Ltd	Mr.Aruna
13. Jinasena agricultural Machinery (Pvt) Ltd	Mr Nishaya Ranwala
14. Onak ERP training academy (Pvt) Ltd	Mr. Mihindu
15. Jinasena InfoTech (Pvt) Ltd	Accountant
16. The Island Watch Company (Pvt) Ltd	Mr.SanjayaKarunarathna(Assistant Accountant)

Appendix 2: Questionnaire

Research on challenges faced in the application of IFRSs for Small and Medium Enterprises (SMEs)-A case study

Section 1: Demographic Background

Please kindly tick (✓) your answer in the appropriate boxes or respond by writing if required.

1. Gender:

☐Female

☐Male

2. Academic level:

☐Technical / vocational certificate
(Diploma)

☐Master's degree

☐Other (specify)

☐Bachelor's degree

3. Working Experience:

☐Less than 5 years

☐16 to 20 years

☐6 to 10 years

☐Over 20 years

☐11 to 15 years

4. Current position in your organization_____

Section 2: Adoption and practices of International Financial Reporting Standards (IFRS) for SMEs in your company.

5. When did your company start using IFRS for SMEs? Please state the year_____

6. Before the adoption of IFRS for SMEs, What reporting standards did your company use?

Please mention the previous standard_____

7. If you compare the previous standard to the IFRS for SMEs, which one is more preferable?
Please underline your answer

(A) Previous standard

(B) IFRS for SMEs

8. What are the two main reasons for your preference? Please state your reasons:

(I)_____

(II)_____

Section 3: Your perception towards factors that could affect the Adoption of IFRS for SMEs by Sri Lankan small and medium companies and the benefits and challenges of adopting it.

In this section the researcher is seeking your specific perceptions toward the adoption of IFRS by Sri Lankan small and median entities. Please kindly indicate the appropriate scale for your opinion by ticking (✓) on the spaces that indicate your choice from the options that range from ‘**Strongly Disagree (SD), Disagree (D), Neutral (N), Agree (A) to Strongly Agree (SA)**’.

A. Factors affecting IFRS for SMEs adoption

	SD	D	N	A	SA
Government policy					
9. The Sri Lankan government encourage companies to adopt IFRS for SMEs	()	()	()	()	()
10. Politics is one of the major barriers to adopt IFRS for SMEs	()	()	()	()	()
Company size					
11. Size of capital may lead to adoption of IFRS for SMEs	()	()	()	()	()
12. Size of companies determines early adoption of IFRS for SMEs	()	()	()	()	()
Educational level					
13. Having trained people in place greatly influence the adoption	()	()	()	()	()
14. Weak educational level of accountants is barrier for the adoption of IFRS for SMEs	()	()	()	()	()
Other factors					
15. Professional support with IFRS for SMEs experience	()	()	()	()	()
16. The absence of capital market in Sri Lanka has negative impact on the adoption of IFRS for SMEs	()	()	()	()	()
Adoption of IFRS for SMEs improves the efficiency of 17. financial reporting	()	()	()	()	()
18. Adoption of IFRS for SMEs is costly	()	()	()	()	()
Financial statements based on IFRS for SMEs are reliable 19. and comparable	()	()	()	()	()
20. IFRS for SMEs adoption result in Reduced cost of capital	()	()	()	()	()

21. It provides greater reporting transparency	()	()	()	()	()
Adoption of IFRS for SMEs improves effectiveness of					
22. financial reporting	()	()	()	()	()
Adoption of IFRS for SMEs achieves the objectives of					
23. financial reporting	()	()	()	()	()

b. Challenges of IFRS Adoption

24. Adoption of IFRS for SMEs is costly	()	()	()	()	()
IFRS for SMEs increases the complexity of financial					
25. reporting	()	()	()	()	()
There is a lack of IFRS for SMEs implementation					
26. guidance	()	()	()	()	()
27. IFRS for SMEs brings about increased volatility of Earnings	()	()	()	()	()
28. Tax driven nature of previous standards is a challenge for IFRS for SMEs adoption	()	()	()	()	()
29. Lack of availability of competent specialists	()	()	()	()	()
30. Need for training	()	()	()	()	()
31. Lack of proper instructions from regulatory Bodies	()	()	()	()	()
32. Problem with the IT system in handling the transition to IFRS for SMEs	()	()	()	()	()
33. Problem with IFRS for SMEs use of fair value accounting	()	()	()	()	()
Lack of clear and coherent accounting practices					
34. application	()	()	()	()	()
Insufficient reference materials for the guidance of					
35. accounting process	()	()	()	()	()
Lack of practical knowledge to convert current practices					
36. in to IFRS for SMEs	()	()	()	()	()
Weak advocacy by the local institute of Accountants has also made a challenge for the application of IFRS for					
37. SMEs.	()	()	()	()	()
IFRS for SMEs does not provide the solution for the accounting issues at any time which may pave the way					
38. to go for a another accounting frame work	()	()	()	()	()

Section 4: Company profile

The following questions seek general information about your company. Please provide your response by ticking (✓) or writing.

39. Identify the primary business of your company:

☐ Finance/banking

☐ Merchandising

☐ Manufacturing

☐ Service

40. What is the capital of your firm?

☐ Less than Rs. 500,000

☐ Rs. 500,000 to 1.5 million

☐ Over 1.5 million

Additional Comments

****Thanks for your kind corporation****