

Decision usefulness of the accounting standard '*IFRS for SMEs*': Qualitative evidence from Sri Lanka

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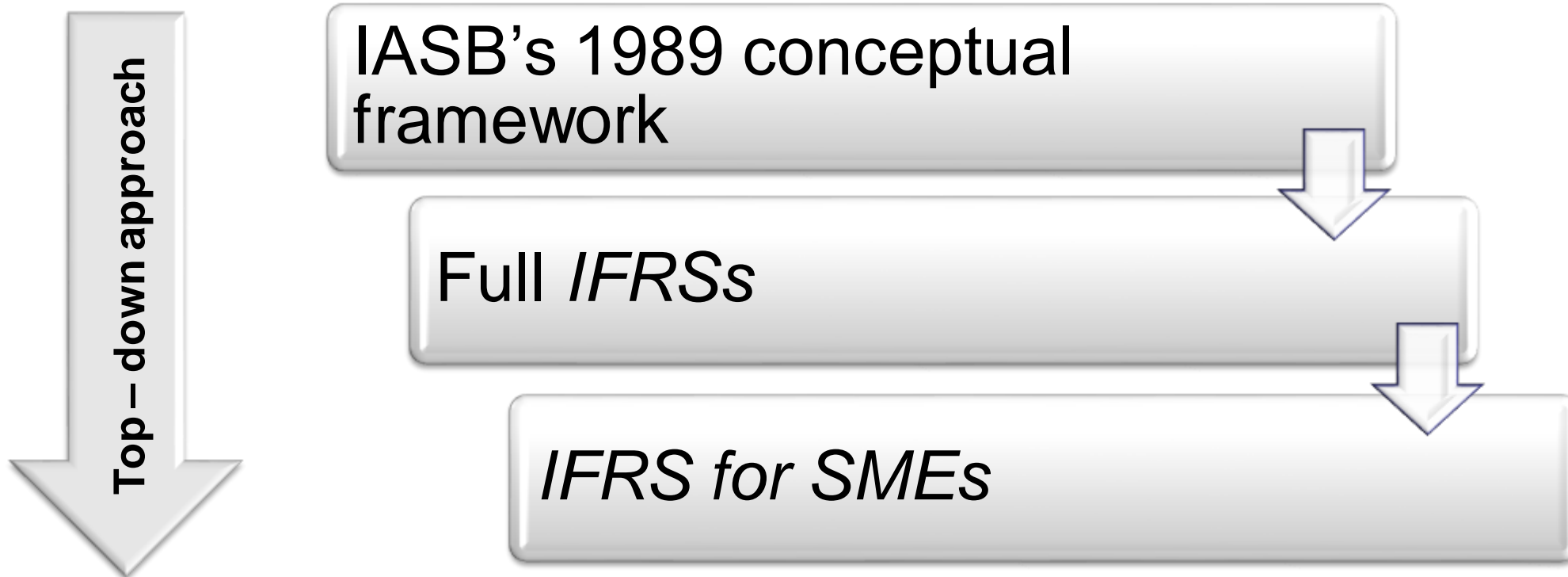
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Background

- IASB published the accounting standard *IFRS for SMEs* on July 2009





Background

- Even though the IFRS for SMEs is simpler than the full IFRS, its framework focuses strongly on outside equity investors as the main users of financial statements (Devi & Samujh, 2014; Di Pietra et al., 2008; Evans et al., 2005).
- Ram (2012) argues that existing literature does not adequately address the users of SMEs' financial statements and their information needs, which is a problem for regulators.



Background

- There is a lack of clarity about the users and their uses of SME financial statements.
- Evidence is lacking on the extent SME financial statements is used by bank lending officers and income tax officers for their decision making.



Background

- Consequently, fundamental questions about the identity of the users and how they use SME financial statements, remains unexplored.
- Research on SME financial reporting in emerging economies is limited.



Contribution of the paper

- Findings of the paper provide fresh insights on the decision usefulness of the accounting standard IFRS for SMEs.
- up-to-date empirical data obtained on users and their financial information from this research is useful in evaluating accounting standards for SMEs.
- Given the dearth of empirical literature about the users and uses of SME financial statements in emerging economies, the results of our study are of special relevance to national and international standard setters grappling with the on-going development of financial reporting frameworks for SMEs.



Literature review - Gaps

- Many researchers (see for example: Barker & Noonan, 1996; Collis & Jarvis, 2000; Haller & Eierle, 2007; Maingot & Zeghal, 2006; Page, 1984; Rennie & Senkow, 2009; Sian & Roberts, 2009) survey the views of a single user group.
- Much of the data used in the literature is now dated and most has been collected prior to 2010. Since 2009, SME financial reporting frameworks have undergone substantial reform. For example, the IASB introduced the IFRS for SMEs in 2009 and many countries, including Sri Lanka, subsequently adopted that standard.
- There is a lack of empirical research to ascertain who are the users of SME financial information and their information needs.



Literature review - Gaps

- Postal questionnaire surveys with owners of SMEs and auditors of SME financial statements dominates the literature
- With the exception of one research study in Vietnam (Dang-Duc et al., 2006), research has not evaluated the decision usefulness of SME financial statements in an emerging economy.
- The decision usefulness of the IFRS by SMEs has not been adequately explored.



Financial reporting environment in Sri Lanka

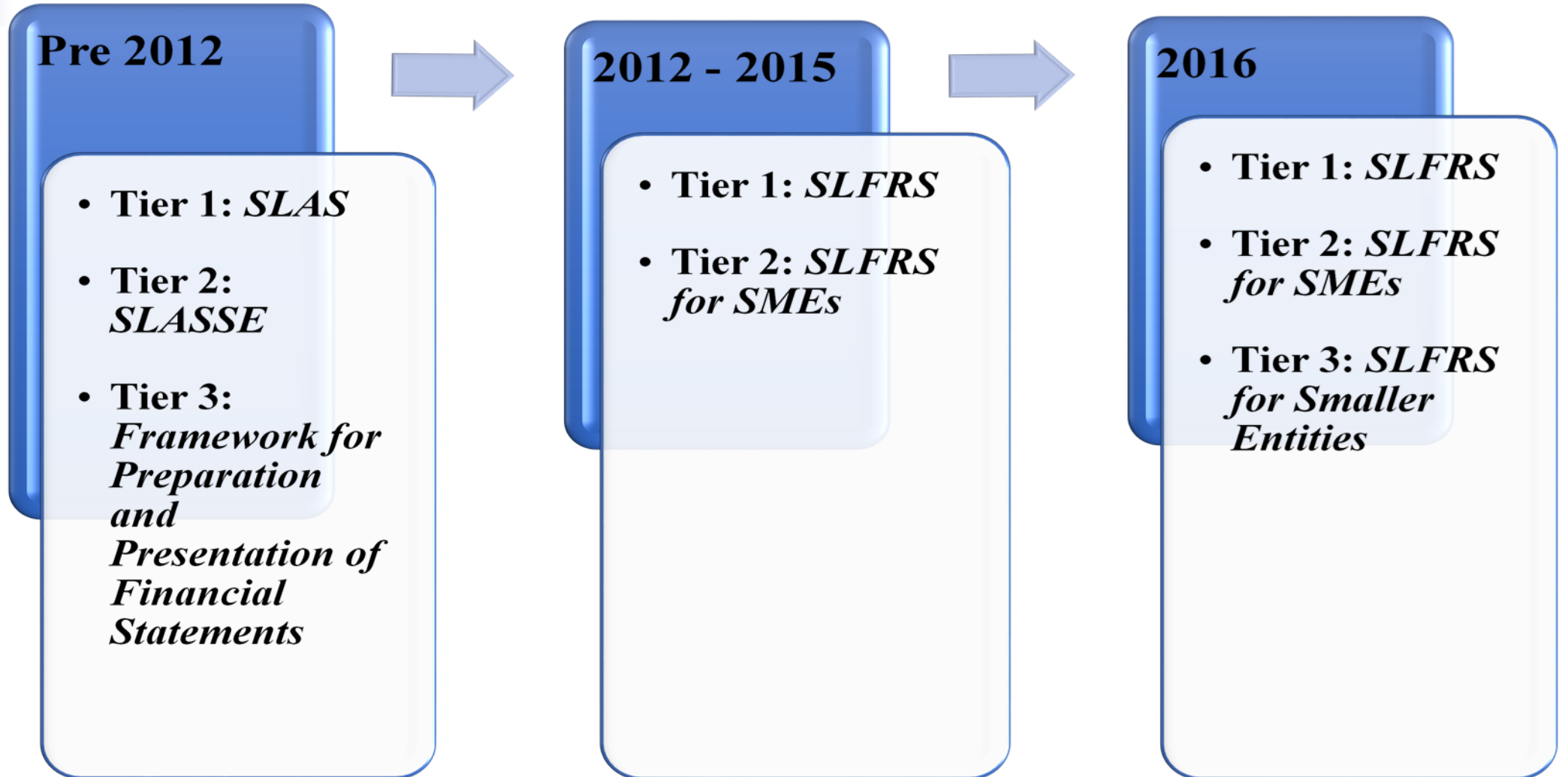
- Sri Lanka was an early adopter of the IFRS for SMEs in the Asian region and required all non-public accountable entities to comply with IFRS for SMEs for the reporting period beginning on or after 1 January 2012.
- Financial reporting in Sri Lanka can be traced back to the ninth and tenth centuries (Liyanarachchi, 2009).



Financial reporting environment in Sri Lanka

- Archival evidence shows that Buddhist monasteries were required to maintain accounting records and to read these records publicly, every year (Liyanarachchi, 2009).
- The British colonial period is seen to be the most significant in influencing Sri Lankan accounting practices (Narayan, Lakshman, & Reid, 2002).

Evolution of financial reporting framework of SL



Current financial reporting framework in SL

Tier 1	Tier 2	Tier 3
<p><i>Sri Lanka Accounting Standards (SLFRS)</i></p>	<p><i>Sri Lanka Accounting Standards for Small and Medium Sized Entities (SLFRS for SMEs)</i></p>	<p><i>Sri Lanka Accounting Standards for Smaller Entities (SLFRS for Smaller Entities)</i> (Introduced effective from 1 January 2016)</p>
<p>SBEs and companies with public accountability</p>	<p>Without public accountability</p>	<p>(a) revenue less than Rs. 100 million in the reporting period; (b) equity less than Rs. 50 million at the end of the previous reporting period; (c) is not required by company law to prepare group financial statements or (d) does not hold assets in a fiduciary capacity as one of its primary business</p>



Research questions

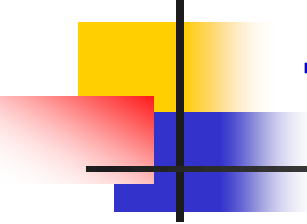
1. Who are the users of Sri Lankan SME financial statements?
2. What uses do they make of the SME financial statements?



Research method

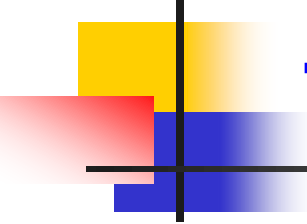
- Forty-one participants are selected from six user groups of SME financial statements to investigate SME users and their financial information needs in Sri Lanka.

Group	Subtotal
Owner-managers	23
Accountants	6
Bank lending officers	5
Income tax officers	3
Standard setter	2
Government institutions	2
Total	41



RQ 1 : Who are the users of Sri Lankan SME financial statements?

- Banks, the Inland Revenue Department, and Government institutions are identified as the most important users of SME financial statements. Income tax officers and bank lending officers use of the financial statements as part of their assessments for taxation and for lending.
- Government institutions use SME financial statements (e.g. the Board of Investment of Sri Lanka, and the Sri Lanka Customs).



RQ 1 : Who are the users of Sri Lankan SME financial statements?

- Owner-managers do not make use of their financial statements for their business decision making. Non-governmental suppliers and customers are not identified as users of SME financial statements.
- Stewardship is not one of the main objectives of SME financial reporting in Sri Lanka since most of the SMEs are owner managed and non-manager owners are not identified as an important user of SME financial statements.

RQ 2 : What uses do they make of the SME financial statements?



- For most SMEs, financial statements were prepared by their external accountants as a 'legal' document to be submitted for certain purposes, especially for taxation.
- In contrast to the IASB's view on the usefulness of SME financial statements for lending decisions, there was a consensus among bank lending officers that the financial statements provided by SMEs have limited use for lending decisions. There is no statutory requirement for public disclosure of SME financial statements in Sri Lanka and their reliability for decision-making is questionable.

RQ 2 : What uses do they make of the SME financial statements?



- Both income tax officers and bank lending officers have serious issues with the reliability of financial statements.
- Quality and credibility of external professional accountants who provide accounting and auditing services to SMEs also appear to be troublesome for bank lending officers and income tax officers.
- The weak legal and regulatory mechanism in Sri Lanka aggravates this situation.



Conclusion

- Stewardship is not one of the main objectives of SME financial reporting
- Users of SME financial information perceive little decision usefulness of SME financial statements
- It appears that poor governance and low enforcement of rules and regulations in Sri Lanka impact on the quality and credibility of SME financial reporting. For example, SMEs tend to alter their financial statements for tax purposes.
- Policy makers should adopt effective mechanisms to minimize noncompliance with rules and regulations of the country.



Conclusion

- The research results suggest that CASL should pay a greater attention to SME financial reporting and take steps to make it credible, relevant, and appropriate to the financial reporting needs of users of SME financial statements, through education, registration and monitoring of their accountant and auditor members.



Thank you...
