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Preliminary Insights on the Adoption of International Financial Reporting Standard (IFRS) for Small and Medium Enterprises (SMEs) in Pakistan

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ABSTRACT

This study aims to investigate the perceptions of accountants regarding the possible adoption of International Financial Reporting Standards (IFRS) for SMEs in Pakistan. IFRS for SMEs were issued by the IASB in 2009. The adoption of the IFRS for SMEs in Pakistan has been proposed by the Institute of Chartered Accountants of Pakistan (ICAP) and in 2015 the Securities and Exchange Commission of Pakistan (SECP) has approved the adoption of the International Financial Reporting Standard for Small and Medium Sized Entities. We conducted seven semi-structured interviews with the chartered accountants based in Multan that were providing accounting and consultancy services to various SMEs. The findings of the research confirmed the reasonable level of awareness among chartered accountants regarding IFRS for SME. Our respondents perceive high-quality comparable financial information as the most significant advantage of applying IFRS for SMEs whereas cost burdens on firms and lack of trained personnel were perceived as major obstacles for the adoption decision. The findings also suggest that diligent IFRS awareness and training programs must be organized by all regulatory and professional bodies (like SECP and ICAP) on both country and firm level to achieve the true purpose of this adoption.

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1. Introduction

Because of rapid globalization, those business entities (whether large or small) are well recognized that are using international standards (Zeghal & Mhedhbi, 2006). International integration of the markets also poses unique challenges to business entities, whether large or small. These challenges are further exacerbated because of the differences in the cultural, economic, social, historical and political structures of different countries which leads to diversity of accounting technologies (Haverty, 2006). One solution to this problem is the standardization of financial reporting that should decrease the diversity of accounting

practices and enables globalization and greater economic integration (Cai & Wong, 2010). International Accounting Standards Board (IASB) was created to serve this purpose. To enhance the comparability of financial statements across the world, the IASB issued a common set of standards known as International Financial Reporting Standards (IFRS). Large-sized companies remained the main subject of these IFRS whereas financial reporting needs of small and medium enterprises were largely ignored.

The small and medium enterprises (SMEs) are considered as the engine of prosperity, economic growth and national development, both in developed and developing countries (Ojeka, 2011). SMEs represent somewhere around 70% and 90% of employment and greater than 70% of national yield. Within the European Union (EU), SMEs constitute at least 99% of all enterprises, maintain nearly 65% of the employment in the private sector and produce considerably more than 50% of the gross domestic product (Mantzari et al., 2009). Emerging and developing economies (like Taiwan and China) are also dominated by SMEs. Taiwan is the most flourishing developing nation over the last 50 years; build on an energetic SME sector. The SME sector of Pakistan also represents 90% of the entire business enterprises and contributes 40% to national GDP.

It is time-consuming, expensive, complex, and burdensome to get the understanding of any SMEs financial statements which are prepared according to its own jurisdiction's standards and regulations. It is only possible with the adoption of globally accepted standards to achieve the international comparability in financial reporting by listed entities as well as non-listed entities. Therefore, a group of practitioners consisting of business entities, financial institutions, regulatory authorities, auditors and accounting professionals accepted the need for internationally accepted financial reporting standards. These practitioners develop a standard with such qualities and acceptable features to gain momentum all over the world. First, International Financial Reporting Standards were built to meet the requirements and needs of listed entities also called full IFRS. Secondly, another set of standards, named as International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs) were built to fulfill the needs of the SME sector. IFRS for SMEs is considered as an important milestone in the development of international accounting harmonization. The adoption of IFRS for SME deemed to improve the confidence level of worldwide investors and investment analysts in the financial statements of companies (Okpala, 2012).

Adoption of IFRS is not just an accounting practice, but it is an adaptation that requires contribution and enforcement from all stakeholders including preparers, auditors and users. This fact must be considered that in certain cases adopting and implementing IFRS may cause unjustified suffering to the business. For example, Pakistan's banking sector was not equipped to apply the requirements of IAS 39 at once because of capacity and some other associated issues. Some short-lived actions had to adopt, like to provide them with adequate time for gradual implementation ("Review of practical implementation issues", 2007). The adoption of the IFRS for SMEs in Pakistan has been proposed by the Institute of Chartered Accountants of Pakistan (ICAP) and in 2015 the Securities and Exchange Commission of Pakistan (SECP) has approved the adoption of the 'International Financial Reporting Standard for Small and Medium Sized Entities. The IFRS for SMEs would replace the Pakistani Accounting and Financial Reporting Standards for Medium Sized Entities issued by the ICAP. The IFRS standard SMEs consists of 35 chapters, 230 pages addressing all the requirements for SMEs.

The purpose of this paper is to get preliminary insights on the level of preparedness of SMEs for the adoption of the IFRS for SMEs. Entities' preparedness will be measured by the indicators such as the training of accounting professionals, availability of training material regarding IFRS for SMEs in documented form, seminars, workshops and use of accounting software. We examined emerging market like Pakistan because emerging market seems more eager to adopt international standards. The implementation of IFRS for SMEs in emerging markets is likely to improve the economy's flow of capital, distribution of resources, countrywide financial reporting model and will give an image and reputation as an up to date, well organized and well-regulated economy to conduct business activities

(Jermakowicz and Gornik-Tomaszewski, 2006; Irvine, 2008; Madawaki, 2012).

The most significant actor in the adoption process of IFRS for SMEs are the accounting professionals. Their support, obligation and commitment are very important in an effective adoption process. All the possible problems, issues and obstacles in the adoption process can be resolved by the joint efforts and support of SMEs, regulatory bodies, and accounting professionals. Therefore, the preparedness as well as the perception of professional accountants about the challenges and benefits of IFRS for SMEs will play a very important part in a victorious adoption procedure. Our research is aimed to investigate the perception of the accounting professionals regarding the level of preparedness of Pakistani SMEs and the associated benefits and challenges in the adoption of IFRS for SMEs. This research has implications for regulators and practitioners in the adoption process. This paper informs regulatory bodies to take some measures for the effective adoption and implementation of IFRS for SMEs. This paper contributed to the limited literature on IFRS for SMEs adoption in emerging and developing economies. Many jurisdictions are planning not to adopt this set of standards due to various complications and contentious issues in the adoption of IFRS for SMEs. On the contrary, many jurisdictions around 78 out of 150 jurisdictions adopted or are in the process of adopting IFRS for SMEs. The following study will consider the thrust for successfully achieving accounting convergence with IFRS for SMEs in one of these jurisdictions like Pakistan.

2. Literature Review

IFRS for SMEs is an essential landmark in the development of global accounting synchronization. It was published to make financial reporting simple all over the world. In July 2009 the IASB released IFRS for SMEs. This was a five-year development process involving wide-ranging global consultation. IFRS for SMEs is a self-sufficient standard well suited to fulfil the requirements and competencies of smaller entities. IFRS for SMEs provides a standard for those entities in any jurisdiction where there is no national GAAP. One of the purposes behind the establishment of IFRS was to provide with a substitute to those countries that already have an established national GAAP and hence will be familiar across diverse territories. It will be easy for the emergent entities switch to full IFRS when they develop into publicly accountable entities. It can be adopted by any jurisdiction for small and medium sized entities. It is up to the jurisdiction to decide which enterprises should use this standard. There is only one restriction on this adoption is that listed companies and financial institutions should not use it. Internationally more than 99% of private enterprises are expected to be qualified to adopt this IFRS in their jurisdictions for SMEs (PWC, 2009).

The IFRS for SMEs is a self-contained, 230-page standard designed to produce general purpose financial statements that represent financial position, cash flows and operating results of SMEs. Based on a full set of IFRS, the simplifications were made by taking into consideration different user needs. It is customized for the competencies and requirements of smaller businesses. It is well understood all over the world. There are five main types of simplifications in the IFRS for SMEs as compared with full IFRS and many other national GAAPs. These simplifications make IFRS for SMEs smoother and easier than the full set of IFRS. Some topics were omitted in the IFRS for SMEs as they were irrelevant to typical SMEs, e.g. earnings per share, interim financial reporting, and segment reporting are omitted in IFRS for SMEs. Many of the recognition and measurement principles that are in full IFRS are simplified in the IFRS for SMEs. For example, amortize goodwill; expense all borrowing and R&D costs; cost model for associates and jointly-controlled entities; no available-for-sale or held-to-maturity classes of financial assets. Substantially fewer disclosures (3000 disclosures vs 300) are required in IFRS for SMEs. IFRS for SMEs are less intricate as compared to full IFRS. In IFRS for SMEs there is simplified redrafting for easier understandability and translation.

2.1 Adoption of IFRS for SMEs around the world

IFRS for SMEs is warmly welcomed by many international accounting groups like the World Bank, the G20, ACCA, European Federation of Accountants, IMF, Basel Committee, IOSCO and IFAC and the

AICPA. According to these global accounting groups the quality, reliability and comparability of financial reports of small and medium sized entities will be enhanced by this adoption all over the world. Capital access for SMEs will also gain momentum across the border. By this adoption all users like suppliers, creditors and investors will get benefits. All these benefits are the main reason for the development of IFRS for SMEs. When the investor will get reliable information from the financial statements, then an important public interest will be served. Similarly, when creditors gain the confidence on the financial statements of SMEs, it will become easy for the SMEs to gain capital. So, by this adoption all the benefits will be attained by the SMEs (Pacter, 2014).

The adoption of IFRS for SMEs is not uniform and is questionable. Developed economies are reluctant to embrace this standard as compared to emerging and developing economies. The reason behind reluctance for the adoption is that developed countries have their own well-established standards. They claimed that these standards are unsuitable for their SMEs sector as their markets are more established as compared to those in the emerging and developing countries. For instance, well-known and developed economy embraced full IFRS like UK, Australia and European Union member states have not adopted IFRS for SMEs. Australia clearly declared that it will not implement this standard for SMEs. Australia is with the view that this reporting standard has many inherent flaws. The implementation of IFRS for SMEs is difficult as there is a low level of corporate culture in SMEs. The difference between tax legislation and IFRS for SMEs is also the reason behind its non-adoption (Poroy & Sipahi, 2007). There were 66 jurisdictions in September 2010 that have adopted or planned to adopt IFRS for SMEs. This quantity is raised to 73 jurisdictions in January 2011. According to International Accounting Standards Board (2012), some of the emerging countries like Argentina, Brazil, Egypt, Hong Kong, Malaysia, Nigeria, Peru, the Philippines, Turkey, Venezuela, Zambia, Zimbabwe, Singapore, etc. had planned to adopt the IFRS for SMEs after the subsequently three years following the year of 2012. It can be shown from this record that most of the emerging economies have embraced or plan to embrace the IFRS for SMEs in their jurisdictions in the nearby future (Vasek, 2011). According to Stainbank (2008) South Africa was the first economy to adopt the IFRS for SMEs across the world. In Asian context, countries that have adopted the IFRS for SMEs include; Bangladesh, Hong Kong, Israel, Myanmar (Burma), Singapore and Sri Lanka, Turkey, Netherlands, Romania, Fiji, South Africa, Kenya, Tanzania, Zimbabwe etc. Countries that have planned the adoption are Bhutan, Jordan, Lebanon, Pakistan, Palestine, Qatar and Saudi Arabia etc. Countries – that have not adopted the standard are India, China, Malaysia, Japan, Indonesia, Middle East (Saudi Arabia, Jordan, Lebanon, Qatar and Palestine) and Korea etc.

2.2 IFRS for SMEs in Pakistan

In Pakistan there are nearly 50,000 non-listed companies as compared to 600 listed companies. So, there is a need of separate accounting standards for SMEs to meet the needs of users of such enterprises. On 01 July 1961, The Institute of Chartered Accountant of Pakistan (ICAP) came into existence with the key intention of regulating the profession of accounting in Pakistan. ICAP is working as a leading regulatory authority for the progress and development of the accounting profession in the Pakistan. It works in connection with the Securities and Exchange Commission of Pakistan (SECP). The SECP has the power to report accounting principles for both listed and non-listed companies. On 15 September 2015, the Securities and Exchange Commission of Pakistan (SCEP) issued Statutory Notifications 928(I)/2015 and 929(I)/2015 for adoption of financial reporting standard for small and medium sized entities. As per the notification, following companies are mandatorily required to use IFRS for SMEs for preparation of their financial statements: Medium Size companies (other than public interest companies) which have paid up capital above Rs.25 million, but less than 200 million or turnover exceeding Rs.100 million, but less than Rs.1 billion. Not for Profit Small and Medium Sized Company (other than large sized companies) which has annual gross revenue/grants/income/subsidies/donations) including other income/revenue less than Rs.200 million. These companies have the option to choose full IFRS Standard being adopted in Pakistan (<http://www.ifrs.org>). Small size companies (other than public interest companies) having paid up capital not exceeding Rs.25 million, and turnover not exceeding Rs.100 million have an option to prepare their financial statements. Although SECP has issued Accounting and Financial Reporting Standards (AFRS)

for Small Sized Entities (SSE).

2.3 Stakeholders' Perception of IFRS adoption for SMEs

Since the IASB issued IFRS for SMEs, few surveys were conducted for understanding the views of practitioners, academicians, and other professionals (see e.g., Durocher & Fortin, 2011). Few short articles have been written in professional accountancy magazines about the adoption of IFRS for SMEs. Except few studies, discussed in this literature review, there is a scarcity of research on the topic. (Christie, Brozovsky, & Hicks, 2010; Jermakowicz & Epstein, 2010; Seifert & Lindberg, 2010).

Albu et al., (2013) explored the perceptions of the users of SMEs in four growing economies, including the Czech Republic, Hungary, Romania, and Turkey. Semi-structured interviews were conducted to investigate the possible adoption issues of the IFRS for SMEs. The results showed that the respondents support a mandatory approach rather than convergence approach and their perception about the benefits of this adoption includes improved clearness, comparability, highly credible accounting and financial information, foreign investments, and increased financing opportunities. This adoption will provide new ventures to establish business on both national and international level. It is illustrated that mandatory adoption of IFRS for SMEs is highly supported by the end users and auditors of financial statements. Preparers and professional bodies favor voluntary adoption of IFRS for SMEs to prepare themselves for better and effective adoption.

Many US studies have assessed the relevance and implementation of IFRS in the context of its benefits to the preparers and users of the financial information. Brown (2011) investigated the benefits to be gained by the preparers and users by this adoption. The financial statements become comparable, transparent and more relevant.

Alp & Ustundag, 2009 carried on the debate on issues of IFRS adoption for SMEs. They investigated that the transition process towards IFRS for SMEs has started with the commencement of full IFRS. They reported many implication problems in the transition from national and local standards to international financial reporting standard for non public firms. Uyar & Güngörmüş (2013) conducted a questionnaire survey in Turkey to explore the awareness and knowledge of the accounting personnel regarding international financial reporting standards for small and medium sized entities. The results showed that the accountants less informed about the omitted topics. Their information about the measurement and recognition principle is satisfactory. The advocates of this adoption exceed the number of opponents.

Kennedy and Emmanuel, 2013 conduct study and revealed that even with the benefits, the SMEs are less sure about the benefits and more concerned about its adoption cost. As a result, varied reactions are continuous to be voiced through the debates on the eradication of local reporting standards for international reporting standards.

Uyar and Ataman (2014) reported the reasonable level of awareness of Turkish accountants regarding the adoption of international financial reporting standards for small and medium sized entities. Albu et al., (2013) investigated the knowledge and perception of stakeholders regarding the possible challenges to be faced by this adoption. The stakeholders perceived that the conversion cost to this standard includes trainings of personnel, cost of hiring expert and auditors and cost of upgrading the previous accounting software. Even with the challenges they are much sure about the benefits of this adoption like it would bring positive and healthy change in the accounting traditions and cultural values. It will also change the attitude of professional accountants and corporate culture in SMEs.

3. Research Methods

This paper adopts the qualitative methodology. Semi-structured interviews were conducted with the Chartered Accountants (CA) firms that deal with small and medium enterprises in Multan, Pakistan. CA firms were taken into consideration as their accountants are dealing with SMEs and they are aware of both the international developments regarding IFRS and local issues regarding SMEs. These chartered accountants provide the SMEs with consultation services, audit services and assist these SMEs in the preparation of financial statements. We conducted seven interviews from chartered accountants in Multan.

We adopted convenient sampling approach for the selection of interviews. We prepared and followed the interview guide (see Appendix A) that was used to probe themes related to the research objectives of this study. The interviews were then transcribed and analyzed manually to get empirics related to various issues related to the IFRS for SMEs adoption in Pakistan. The following section presents empirical findings that came out from this analysis.

4. Findings and Discussion

4.1 Level of preparedness of IFRS for SMEs in Pakistan

The IFRS adoption will be effective if there is an appropriate level of awareness among the SMEs, accounting professionals, academic persons and all other stakeholders. All these parties play a significant role in the effective adoption process. The cooperation and collaboration among all these parties will make it easy to carry on the transition process towards IFRS for SMEs in a smooth manner (Kenneth & Grazyina, 2013). When the discussion on IFRS adoption for SMEs is started with the interviewees they all were aware about this standard to be applied in the following financial period. All of them knew about the implementation of this standard. The financial period in Pakistan ends in June. From January 2015 to June 2017 there is a transition period. Financial statements made from June 2018 onwards will be according to this standard. As the accounting professionals are closely dealing with the preparation of financial statements so they are well informed about the adoption process of IFRS for SMEs. However, in the view of accountants, the awareness level of owners and managers of SMEs is low.

“We are very aware regarding IFRS for SMEs. The previously used Accounting and Financial Reporting Standards (AFRS) for SMEs are now replaced by IFRS for SMEs. Now we are switching towards IFRS for SMEs and are facing the transition phase.... but when we talk about the owners and managers of SMEs they have low level of awareness about this standard.”

All the preparers and users of financial statements, auditors and regulatory authorities must have adequate practical knowledge for sensible execution of IFRS. The lack of well trained personnel and accountants might lead towards poor implementation of IFRS for SMEs. This poor implementation is based on the approach adopted by the SMEs for IFRS adoption (Adekoya, 2011). When asked about the number of training sessions attend by the accountants, they revealed they attend just one training out of four training sessions conducted by ICAP Multan.

“We actually don't need too much training as compared to the managers and owners of SMEs as we are already dealing with full IFRs for large sized companies, so we have to just use smaller contents for IFRS for SMEs as compared to full IFRS.”

There must be a sufficient time span between the effective and implementation date of IFRS for SMEs. But this time span is usually not provided in many jurisdictions. If there will be ample of time for the trainings of personnel then this adoption will truly fulfil its essence (Adekoya, 2011).

“There must be enough time for the trainings of accountants. In Pakistan there is ample time between the decision date and implementation date to make necessary measures for the implementation of this standard.”

After the adoption of IFRS for SMEs, SMEs and accountants might encounter the cost of adopting new accounting software systems (Tyrrall et al., 2007). In the adoption of IFRS for SMEs the SMEs must bear the cost of upgrading their accounting software programs to match the requirements of this standard (Ballas et al., 2010). Inadequate level of education among the preparers of financial statements along with the poor accounting programs results in poor implementation of IFRS for SMEs (Roberts and Sian, 2006). When asked about the interviewee whether they are using the previous accounting systems or switching to new systems, one of the respondents responds in this way.

“There is not an issue working with the previous accounting software systems as our software is compatible with IFRS for SMEs.”

Professional accountants play a vital role in the successful adoption process. There must be sufficient training materials on IFRS for SMEs that should be easily accessible at minor cost or free of cost from the regulatory authorities in each jurisdiction. The SMEs have to face the affordability cost in terms of training resources and arranging meeting from the spare time of daily operations (Adekoya, 2011). When asked about the training resources and meeting regarding IFRS for SMEs, one of the interviewee replied.

“We have pocket guides provided by SECP in which there is a complete package of understanding about IFRS for SMEs. There are just a few meetings conducted in this respect which is sufficient for our understanding and applicability of this standard.”

The aptitude of accounting professionals depends on accountant’s knowledge regarding full IFRS, promptly upgrade and adopt the new regulations, and on the sufficient trainings of accounting personnel on a regular basis (Chand et al., 2015). It is necessary to arrange meetings regarding IFRS for SMEs must be held to make sure about the pure application by the professional accountants.

The implementation of IFRS for SMEs in developing economies is less favorable due to the shortage of expertise and insufficient resources. In the developing countries there is inadequate facilitates to make advancements in infrastructure (Briston 1978; Wallace 1990; Nobes 1998). The cultural values of developing countries are typically dominated by a concept of an entity that is part of the community with respect for family and tradition, and cooperative behaviour in a hierarchical form (Liñán and Fernandez-Serrano, 2014). When asked about whether it is economically favorable for the SMEs to adopt these standards some interviewees favor this adoption while some go against this due to low level of corporate culture is SMEs. One of opponents among the interviewees said,

“In the economy of Pakistan, where the SMEs are facing low corporate culture, so they are hesitant in the adoption of any new regulations and standards, the applicability of IFRS for SMEs is seemed to be difficult.”

The adoption of IFRS for SMEs will enhance the comparability of financial statements within and across the industry. By adopting same accounting reporting standard comparability will be enhanced (Aljifri & Khasharmeh, 2006). The adoption of IFRs for SMEs will enhance internal reporting reliability as the credibility of financial information will be enhanced (Ballas et al., 2010).

“IFRS for SMEs is economically favorable in Pakistan as it will raise the awareness in the users and owners of SMEs to adopt these standards so that in future when their business will grow into big companies they would have already moved towards standardization. So, it would be definitely favorable for Pakistan economy as it will bring all SMEs at one point in adoption of standard imposed by SECP.”

Albu et. al., (2013) examined the perception of stakeholders regarding this adoption. The stakeholders even with the challenges of high compliance cost are much sure about the benefits of this adoption as it would bring positive and healthy change in the accounting traditions and cultural values. It will also change the attitude of professional accountants and corporate culture in SMEs.

“The adoption of IFRS for SMEs is good in one respect that it will bring uniformity in financial statements. But the negative side of IFRS for SMEs is that is thought to be too large for SMEs to implement. Moreover, its implementation requires the small and large sized companies to have chartered accountants. This will be an additional cost for the SMEs.”

The preparers, auditors, and regulatory bodies must have sufficient technical knowledge about the implementation of IFRS for SMEs. The users of financial statements must also have adequate level of information about the IFRS for SMEs. The accounting department must have business skills and some knowledge in legal aspect (Adekoya, 2011). When asked about requirements of the level of education and information to be required for successful implementation of the IFRS for SMEs then all the respondents are on the same views that the accountants must be well known about the three areas such as business, economics and law.

“The SMEs must have professional and trained accountants having good knowledge of business and legal requirements as IFRS for SMEs are complicated as compared to previous set of accounting and financial reporting standards (AFRS) for SMEs.

“The chartered accountants have more business information and knowledge as compared to those having degrees of bachelors and masters’ in business and commerce. So, SMEs must have some chartered accounts in its accounting department.”

Professional accountants are looked upon to ensure successful implementation of IFRS. All the users of financial statements such as creditors, suppliers and investors must have an adequate level of information about the IFRS adoption for SMEs. The regulatory bodies must also have sufficient information about this standard. All these parties are responsible in the implementation of IFRS for SMEs. So, they must be trained for the proper adoption of IFRS for SMEs.

“For the adoption of International Financial Reporting Standards for SMEs, the accounting professionals and the management of SMEs must have legal, economic, both academic and practical knowledge of accounting and standards. There must be an evaluation appraisal to check and balance the IFRS adoption in a complete manner.”

Those accountants who have degree of chartered accountancy are more professional as compared to those employing in SMEs.

“A healthy no of professional accountants has a good knowledge of full IFRS already. Accountants working in non-IFRS environment need to upgrade their knowledge. In addition, they must have the knowledge in three areas of business, economics and law.”

Before making decision about the IFRS for SMEs, the regulatory authority must conduct some research to test the suitability of this standard in any jurisdiction. This result will elaborate about the local circumstances and user needs of SMEs in a specific territory. Without conducting research about the possible issues of implementations, the SMEs might take this adoption as a burden if it is not in accordance with the local standards (Samujh & Devi 2015).

4.2. Challenges in adoption of IFRS for SMEs

The small and medium sized entities are short with financial resources. So, they must bear huge compliance cost for the adoption of IFRS for SMEs. There must be some time span for the preparation of this adoption. Therefore, this adoption should be made voluntary so that SMEs can prepare themselves for this adoption (Samujh & Devi 2015). A sufficient amount of time will provide the accountant to train themselves for this adoption (Adekoya, 2011). The regulatory authorities must adopt strict enforcement program for effective and successful implementation of IFRS for SMEs.

Some of the interviewees are in the favor of mandatory adoption while the rest said it should be voluntary in the beginning but later it must be mandatory.

“The adoption of IFRS for SMEs should be mandatory to pressurize the SMEs to adopt the standard. Strict enforcement plans must be adopted by SECP to make sure the complete adoption of the standard.”

Before deciding about the adoption of this standard the SMEs must take into account the true definition of SMEs. The SMEs must also consider the suitability of certain disclosures requirements. The first task which must be taken by the SMEs is to announce the transition date. An opening statement of financial position of the SMEs must be generated on this transition date to evaluate how much cost is incurred on the compliance with this standard (Vasek, 2011).

“The adoption of IFRS for SMEs would be mandatory in the beginning so that SMEs can get some time to prepare themselves for the complete adoption of IFRS for SMEs. But later this adoption should be mandatory after transition phase.”

According to Companies Ordinance 1984 5th schedule Medium Size companies (other than public interest companies) having paid up capital exceeding Rs.25 million, but less than 200 million or turnover exceeding Rs.100 million, but less than Rs.1 billion are legally bound to follow IFRS for SMEs in their financial statements.

One of the interviewee said that there must be more relaxation in its adoption by further classifying the paid-up capital into two or three categories. He expressed his views with these words.

“There must be some slabs of paid up capital which would identify whether this adoption should be voluntary or mandatory. According to Act 2017 the medium sized entities (MSEs) having paid up capital greater than 25 million but less than 200 million must adopt IFRS for SMEs. There must be further categorization in paid up capital like for MSEs having paid up capital between 25 million to 100 million there is voluntary adoption and MSEs having paid up exceeding 100 million but less than 200 million there should be mandatory adoption.”

The operations of small and medium sized entities are limited in scope. As the SMEs are domestically based firms hence their requirements are limited. The users of financial statements of SMEs are the suppliers, banks and investors. Among all these users only banks require specific information for granting loans to the SMEs (Chand and White 2005). Another user of SMEs is supplier. The supplier makes dealing with the SMEs on credit bases. To check the financial position and cash flows of SMEs the supplier is very much concerned about the financial statements of SMEs as these reporting will give reliable information. Simply the main users of SMEs are mostly the banks, investors and government and tax authorities. When asked whether IFRSs for SMEs suitable for SMEs in developing countries like Pakistan where the users have limited informational requirements, one of the interviewee said these words.

“IFRS for SMEs in emerging economies like Pakistan is less suitable as information requirements of users are narrow in scope as they are operating domestically. These users just make confirmation to the local laws. These users are not concerned about the international standards and benchmarks. The reporting obligations are smaller in scope. Therefore, the costs incurred on the preparation, audit and the reporting requirement of the additional disclosures cannot validate this adoption.”

The SMEs users just want to know about cash flows, liquidity and solvency. The users of SMEs are mainly concerned on short term forecast rather than long-term forecasts. On the other hand, the users of large companies are concerned about the earnings and share prices (Causer, 2015).

“The main concern of the users of financial statements of SMEs is to get the information about the financial position, performance and cash flows of SME.”

Unlike large sized companies which have more options to raise finance from the credit market and other alternative markets, small firms mainly rely on bank lending. Therefore, among the users of SMEs banks are more concerned about the financial statements of SMEs (Hutchinson and Xavier, 2006).

“Most of the users of SMEs don’t even concern about which standards are being followed by the SME in which they are investing. The users perform the dealings based on personal relations.”

The users of SMEs are less aware about the accounting information revealed by the financial statements. There is a need of awareness programs for all the users who don’t even consider the importance and value of financial statements. These users perform dealings with SMEs through word of mouth communication.

“The users of financial statements are less focused towards the financial statements and hence they don’t have any concern which accounting, and reporting standards are being used by the SMEs. The users of SMEs must be aware of accounting and financial reporting standards.”

Compliance cost includes all the direct and indirect cost that SMEs must bear in order to make necessary adjustment to meet the requirements of international standards. The SMEs must bear the cost on the trainings of accountants and upgrading of accounting programs. Compliance costs also include the cost of time and money incurred on reporting. When asked the interviewees about the compliance cost exceeds benefits, half of interviewees said.

“Exceeding compliance cost than benefits depend on the lenses of seeing this cost. If it is considered as incurring cost at the point of time, then it will seem to exceed the benefits. When looking through the lenses of long term perspective it seems to be more favorable for the economy.”

“The compliance cost for adoption of IFRS for SMEs in early rears will exceed more than benefits but later it will be minimized.”

It has been argued that IFRS reporting costs have fixed reporting segments that cannot be compromised. But these reports and additional disclosure requirements will be burdensome for SMEs (Hail et al. 2010). The SMEs must incur fees on audit of financial statements following the adoption of IFRS (George et al, .2012).

Accounting personnel in the current situation needs training to be able to cope up with the transition phase since IFRS for SMEs is complicated hence difficult to understand so extra knowledge and extra work would require for switching to IFRS for SMEs. So the companies have to put extra cost and time.

“The small and medium sized entities have limited resources and hence they can’t afford big audit and CA firms. This cost can be minimized if they train their own employees.”

Some participants have the vision that the training of personnel will not be high. The training of employees requires minimum affordable cost. One of the participant gave his remarks,

“IFRS for SMEs are not complicated that SMEs have to bear huge cost on the training of their personnel. The IFRS for SMEs is itself stand-alone standard which requires no need to hire expertise.”

SMEs have insufficient financial resources to guarantee compliance with this standard. The SMEs must outsource the accounting professionals. There is a lack of competent accounting accountants and other expertise in the SMEs. Therefore, more training would be needed in its implementation.

“The SMEs are short with both financial resources and relevant expertise which is an obstacle towards this adoption. SMEs can benefit from this adoption in the long run when the initial cost of adoption in future will reduce to zero.”

White et al. (2015) studied that many disclosures in this standard is burdensome and costly. For example, compensation and related party disclosure are burdensome. Small-sized entities generally do not have sufficient financial capacity to overcome the cost of additional disclosure. Furthermore, size is an important factor that determines entities’ ability to adopt the international reporting standards because larger entities have more resources to spend on their preparation and on compliance with them (Murphy, 1999; Jones and Higgins, 2006; Al-Shammari et al., 2008) Some of the respondents have the views that there would be an extra cost on disclosure by adopting IFRS for SMEs. One of the respondents said these words.

“SMEs have insufficient financial resources, so they have to bear cost of additional disclosures in the adoption of IFRS for SMEs and it will be surely cost the SMEs.”

One of the respondents opposed this view of huge cost of disclosure. They argued this adoption will lessen the burden of disclosures.

“There will be reduction in the burden of interpreting accounting principles and complying with differences in reporting requirements. So SMEs will not have to incur cost of additional disclosures.”

4.3. Benefits in adoption of IFRS for SMEs

There are benefits achieved from the adoption of IFRS for SMEs. This adoption will generate more transparent, comparable, and reliable financial information (Jermakowicz & Gornik-Tomaszewski, 2006; Ballas *et al.*, 2010; Uyar & Güngörmüş, 2013). The quality of information in turn enables all the users to understand its meaning (Alfredton *et al.*, 2009).

“IFRS adoption for SMEs will facilitate the financial statements with high quality and comparability to the SMEs. The most significant advantage that this standard will bring is the quality of financial information and the financial statements become comparable within and across the industry.”

According to the respondents, comparability of financial statements is the highest-ranking advantage of the IFRS for SMEs. Comparability refers to the consistency in the financial statements from one to the next period within and across different entities.

“There would be uniformity in financial statements with other countries and easy way of consolidation after the adoption of IFRS for SMEs. Potential advantages of IFRS adoption for SMEs consist of greater transparency in financial statements and providing credible information in accordance with the standards.”

Previous studies showed that the adoption of IFRS for SMEs increases internal reporting reliability and thus reduce the chances of internal corruption (Ballas *et al.*, 2010). IFRS for SMEs will reliability to the financial information. Reliability refers to the information that is unbiased and free from any type material inaccuracy. All the information will truly depict all the transactions or events that it claims to represent (Alfredson *et al.*, 2009, p.16).

“The various benefits associated with this adoption include streamlining of records as all the users of SMEs will easily understand the financial statements and this will lead towards elimination of internal corruption as all the record will be organized in the same way and even more organized information to the management and users of financial statements.”

In some countries the main financing institutions are banks. But these banks don't rely on the financial statements hence there is no role played by the financial statements in capturing capital nor do these standards enhance relationships with banks (Carini *et al.*, 2013). Van Wyk and Rossouw (2009) studied that the banks do not need the detailed financial information in accordance with IFRS for SMEs.

The effectiveness of financial reporting can be ensured as a result of effective communication with related parties, such as the government, banks, shareholders, and partners (Rezaee *et al.*, 2010, Kouser *et al.*, 2012). The IFRS for SMEs will improve this effective communication between related parties (Siam & Rahahleh, 2010).

“In Pakistani SMEs investments are done on the basis of word of mouth communication being applied. The investors are not concerned about which standards are being applied by the SMEs.”

So, this adoption of standard will not enhance the investment opportunities for small and medium sized entities.

This adoption also attracts foreign direct investment. The investors across the globe will confidently invest in the SMEs by relying on financial statements under the IFRS for SMEs (Aljifri & Khasharmeh, 2006; Tyrrall et al., 2007).

“In Pakistan foreign investment is welcomed in the family-oriented business. Like if the relative or siblings of the SMEs’ owners are in some foreign country they are very much willing to invest in those SMEs.”

It is argued from some investigators that there is no benefit for domestic firms to follow IFRS for SMEs as they are not interested in international trading (Lungu et al., 2007).

“In Pakistan there is less attraction by foreigners to invest in SMEs. Mostly local investors are willing to invest in SMEs. There is no direct foreign investment in SMEs as the foreign are less interested in SMEs as they are operating domestically. Foreign investors are willing to invest in large and economically significant companies. So Pakistani SMEs will not get benefit in the regard of attracting foreign direct investment by adopting IFRS for SMEs.”

Based on the results of the study conducted in Nigeria by Gabriel Isu et al., 2014 it is concluded that the progress and success of the SMEs depends on the combined efforts and cooperation by the users of financial statements, accountants and owners of SMEs. They gave the opinion that however the adoption of IFRS for SMEs is expensive and troublesome, yet this adoption will improve sustainability, competitive advantage and potentials for growth of SMEs.

“IFRS alone is not responsible for the enhancement of potential growth, competitive advantage and sustainability of SMEs. IFRS is not the factor influencing potential growth, competitive advantage and sustainability of SMEs rather other factors like the availability of finance, high quality of product, effective management, legal policies of the country, competitive environment and market sustainability.”

Many of the executives in Fiji said some disclosure requirements in this standard are burdensome like related part disclosure and compensation disclosure. They opposed this extra burden of disclosure requirements for SMEs (White et al., 2015). Emergent economies are most probably being motivated towards the adoption of good quality standards of IFRS for SMEs with more organized financial disclosure requirements to gain attention from international financial institutions like World Bank or IMF. Besides the fact that there are many differences between the national accounting standards and IFRS for SMEs, yet these economies are ready to embrace this adoption (Barth et al. 2008, Gordon et al. 2012).

“There is reduction in the burden of interpreting accounting principles and complying with differences in reporting requirements. With every standard there are some interpretations are disclosures which is an essential part of every standard.”

This benefit is less observed in the literature that IFRS for SMEs reduce the burden of disclosure requirements.

“There is a reduction in disclosure requirements only when we compared the IFRS for SMEs with full IFRS. But when we compared IFRS for SMEs with previous AFRS for SMEs, there is definitely a burden for the SMEs in terms of these additional disclosures.”

5. Conclusions

This paper concludes that chartered accountants are well aware and prepared for the adoption and implementation of IFRS for SMEs in Pakistan. This awareness and preparation is because of the number of training sessions and the guidelines that were provided by ICAP. All the accountants have an adequate level of skills and information on business, economics and legal aspects. However, the perception of accountants varies regarding the challenges and benefits associated with the adoption and implementation of IFRS for SMEs in Pakistan. Some argued that the SME sector of Pakistan has lack of finances to train

their employees and establish a new accounting system. In Pakistan markets are less established. The IFRS for SMEs is suitable for the established markets. However, some respondents favor the IFRS for SME adoption to meet the international requirements. This adoption will help in building the image of Pakistan as a modern economy that is willing to embrace globally recognized standards. The responses of the respondents vary as all of them have different level of experiences. Therefore, it seems that the professional accounts are ready to embrace the IFRS for SMEs and their preparation is satisfactory to fulfil the requirements of this standard.

In the perception of accountants, the challenges and obstacles in the successful implementation of IFRS for SMEs include the lack of finances with SMEs. The SMEs are hesitant towards this adoption as they have to bear the compliance cost of training, upgrading the IT department for the upgrading of the accounting department. The compliance exceeds than benefits in the first-time adoption of IFRS for SMEs however later it will be minimized. The compliance costs may include cost in terms of money and time for trainings of personnel and consultancy services. The IFRS adoption for SMEs must be mandatory in the initial time of adoption and then after three to four years of complete understanding of this standard it should be made mandatory adoption.

The needs of users of SMEs in developing countries like Pakistan are limited such as their concern is on short term cash flows and liquidity. The SMEs are limited in scope like they are more focused on survival rather than on growth and profit maximization. Therefore, a question arises about the suitability in this case with limited needs. Although it is the matter of the fact the needs of users of SMEs are limited yet it should be adopted to raise awareness in the users of SMEs to rely the financial statements. The various cost incurred in this adoption may include the cost of additional disclosure requirements and hiring consultants or expertise or outsource professional accountant. Fair value accounting problems also arises as it requires professional judgements about the market fluctuation and market prevailing prices.

There are many expected benefits which the accountants are looking forward after this adoption. After this adoption the financial statements of SMES will become more transparent, comparable and reliable. As reliability means the information that is unbiased and free from any type of material inaccuracy which leads to eradicate the internal corruption and increase the credibility of financial information. IFRS adoption for SMEs would enhance the market efficiency and reduce the cost of raising capital along with making the market tough and raise a competition among the SMEs to gain capital from the banks. It will be easy for the banks to compare the financial statements of different SMEs. This adoption will also attract domestic investment opportunities. There is very low level of foreign direct investment in Pakistan SMEs. There is also a reduction in the burden of interpreting accounting principles as compared to full IFRS but still there is a burden in financial disclosures.

The banks, investors and suppliers which are the main users of financial statements don't focus on which standards are employed by their SMEs clients. In Pakistan most of the business dealings are conducted and approached based on word of mouth communication. There is need of conducting some sort of awareness programs for the users of the SMEs so that could be willing to focus on the financial reporting standards in conducting business dealings rather than their personal contacts.

This paper has certain limitations. This research focused on the preparedness and perception of accounting professionals regarding the adoption of IFRS for SMEs in Pakistan. It does not explore the preparedness and perception of the managers and owners of the SMEs. Due to time and cost limitation the focus of our research work was only on SMEs in Multan. For data collection our respondents are CA firms. The respondents must include the SMEs to capture more information. The study can be extended to other cities and both accountants and managers perception may be explored and then compared. Despite these limitations, the results of this study will be insightful for several parties, including standard authorities, regulatory bodies, entities, accounting professionals, and academicians. For the effective implementation of this standard the regulatory bodies (ICAP and SECP) must take some essential measures for the strict enforcement of this standard. The government and other professional bodies like ICMA must collaborate and coordinate for the effective implementation of this standard in Pakistan. The results of this study may be beneficial also for the standard authorities of other emerging countries. Other emerging countries' standard authorities will take into consideration the findings of this academic study in similar countries to achieve a more effective adoption process.

Appendix A: Interview Guide

The interview guide is ordered into three segments.

- First segment will gather the insight about preparedness of accountants for IFRS for SMEs.
- Second segment deals with the challenges in this adoption and
- The last segment deals with the benefits of this adoption.

Level of Preparedness

1. Are you aware about the IFRS adoption for SMEs in Pakistan?
2. Do you think it will be economically favorable for the SMEs to be imposed with a statutory regulation (SECP and ICAP) to use IFRS for SMEs in their financial statements?
3. How many training workshops and seminars have conducted for personnel and management in order to adopt IFRS for SMEs?
4. For the application of IFRS for SMEs an accountant is required to have knowledge of business and economics along with some skills in account and legal aspects. What is your opinion about it?
5. Have you upgrade your accounting software programs to meet the needs of IFRs for SMEs?
6. Do you have any pocket regarding IFRS for SMEs guide that supports you in the adoption of this standard?

Perception of Challenges

1. What is your opinion about the requirement (voluntary or mandatory adoption) for the implementation of International Financial Reporting Standards (IFRS) for SMEs in Pakistan?
2. Do you think that IFRSs for SMEs are suitable for developing countries like Pakistan since the information needs of users will be limited in developing countries like Pakistan?
3. What is your perception of the various costs associated with the adoption and implementation of IFRS for SMEs?
4. Do you think costs of complying with the IFRS are far greater than the corresponding benefits?
5. Do you think that SMEs in comparison to large companies has limited resources which are one of the major hindrances for going towards IFRS adoption?
6. What is your perception of the level of accounting education and training that is required for the adoption and implementation of the IFRS for SMEs.
7. Do you think that accounting department is capable to move towards the IFRS for SMEs, or the services of consultants are required?

Perception of Benefits

1. What is your perception of various benefits associated with the adoption and implementation of IFRS for SMEs?
2. Do you think that IFRS for SMEs will bring transparency, quality and comparability to the financial statements?
3. Does the IFRS adoption reduces the burden of interpreting accounting principles and complying with differences in reporting requirements?
4. Do you think that investors have more confidence on companies that adopts IFRS?
5. Do you think that IFRS adoption increases market efficiency and reduces cost of raising capital?
6. Does IFRS reporting attract foreign direct investment providing greater access to capital?
7. Does the adoption of IFRS will enhance competitive advantage, potentials for growth and sustainability of SMEs?

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