

ADOPTION AND IMPLEMENTATION OF IFRS: AN IMPERATIVE NEED FOR SMEs IN INDIA

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Voice of Research

Volume 7, Issue 3

December 2018

ISSN 2277-7733

Abstract

Small and medium enterprises (SMEs) have made noteworthy participation towards industrial growth, manufacturing, export and employment creation particularly at the low-skill level. SMEs Employing close to 40% of India's workforce and contributing 45% to India's manufacturing output. Although they employ 40% of India's workforce, they only contribute 17% to the Indian GDP., SMEs play a critical role in generating millions of jobs, especially at the low-skill level. The country's 1.3 million SMEs account for 40% of India's total exports. The movement to IFRS being the global benchmark in accounting standards in gaining momentum with about 100 countries already moving to IFRS as the standard (or at least have converged very close to IFRS). In EU, IFRS is mandatory since 2005. In 2007 China adopted IFRS within 1 year of announcing the changeover. The International Financial Reporting Standards (IFRS) for Small and Medium Scale enterprises is a adaptation and generalization of full international financing reporting standards aimed at meeting the needs of Small and Medium scale enterprises financing reporting and to simplify the financial reporting. The adoption of IFRS across the country is taking place rapidly to bring about accounting quality improvement through a single set of standards for financial reporting. The International Financial Reporting Standards (IFRS) was issued by International Accounting Standards Board (IASB). All major economies have established timelines to converge with, or adopt the IFRS. The adoption of the International Financial Reporting Standards surely will ensure uniformity, comparability and reliability of the financial reporting across the world. The intent of the study is to investigate features of adoption of IFRS and to address issue and challenges while adopting IFRS for small and medium scale enterprises in India and the context of IFRS in Indian Scenario. The paper also identifies benefits for small and medium scale enterprises through adoption of IFRS and to make comparison between India GAAP framework with IFRS for small and medium enterprises.

Keywords: IFRS, Financial Statements, Accounting Principles, Small and Medium Enterprises, Financial Reporting

Accounting is the life blood of the business world. It was started for the development of business, trade and commerce. The theory of assets, liabilities, and income and the need to merge these areas is still the basis for all accounting functions today. Accounting gives the overall financial view of the business in order to make various decisions about the current status or future of business. Every business needs to keep record of basic accounting information. To determine the performance of business organizations, one of the factors is effective use of accounting and financial management reports. It has been identified from the beginning that appropriate accounting information is important for a successful management of a business whether it is large or small. Accounting legislation is used for listed companies, i.e. the International Accounting Standards or International Financial Reporting Standards and for non-listed limited liability companies; the Accounting Directives are being used. No accounting legislation is applicable to those enterprises which are not listed or are not limited liability companies; in most of the cases small enterprises are referred. However, the applications of these techniques are limited in Small and Medium Enterprises (SMEs) in India. There is a wide gap between theory of accounting and financial management and actual practices by the manufacturing SMEs. Accounting information is used to measure and communicate financial information of the enterprise that is needed by management in decision making. Accounting information exerts an important influence on the success of MSMEs, therefore it is important that accounting practice of MSMEs could provide complete and relevant financial information needed by entrepreneurs in decision making. In order to enhance the profitability of MSMEs and their continuity, there is need for adequate record keeping which will help the owners to keep track of the performance of these enterprises. There is a saying that "Money makes the

world go around". This is also true in the case of every business enterprises. An accounting system is the basis of financial management as all the financial data is first of all recorded according to the rules of accounting in the business books of accounts. In order to survive, MSME owners need updated, accurate and timely accounting information.

Objectives of the Study

The objectives comprised to understand the better knowledge on IFRS in Indian Context., to discuss the benefit of adoption and challenges for adoption of IFRS, to compare framework of IFRS for small and medium enterprises with Indian GAAP, to know the features of International Financial Reporting Standards for Small and Medium Enterprises and to study the issues and challenges faced by SMEs in the process of adoption of IFRS in India.

Research Methodology

The study is primarily qualitative in nature and do not use any quantitative tool to analyze the data. It has been conducted mainly on the basis of literature survey and secondary Information. Various journals, newspaper and magazines articles have been referred to in writing this paper.

Need of the study: IASB follows a thorough and transparent due process in developing IFRS as a high quality, globally accepted accounting standards. These standards are not only vigorous but also tend to gain a wide and ready acceptability among the users of financial statements, promote transparency and provide a suitable standard for accounting practices in general. It is beneficial for Indian companies to adopt a standard which provides such credibility to their financial statements and helps them to integrate with the global economy. The International Financial Reporting Standards are progressively replacing the many different accounting standards in the world. Hence in this context there is a need to study the

adoption procedure of IFRS in India and the issues and challenges faced by the Indian SMEs.

Beneficiaries of IFRS: Different countries have different definitions of SME. But for the purpose of the standard, any entity that does not have public accountability, and publishes general purpose financial statements for external users is considered to be an SME. An entity has public accountability if its debt or equity instruments are traded in a public market or it is in the process of issuing such instruments for trading in a public market. This broadly means that any listed company, and in most cases, banks, insurance companies, securities brokers/dealers, unit trusts and investment banks do not meet the conditions to use IFRS for SME. This also means that any private entity can use this standard irrespective of the size, as long as its securities are not listed.

Need of IFRS for SMEs: The International Accounting Standards Board (IASB) has launched International financial reporting standards for the benefits of small and medium sized entities (SMEs), which are estimated to present more than 95 % of all the companies. The standard has been designed to meet the needs and capabilities of SMEs worldwide. The disclosures requirements have been significantly reduced. In Indian context, this standard has great implications. IFRS for SMEs is based on the fundamental principles of full IFRS, but in many cases, it has been simplified to make the accounting requirements less complex and to reduce the cost and effort required to produce the financial statements. Few topics addressed in full IFRS but omitted from IFRS for SMEs because they were not relevant to SMEs such as earning per share, interim financial reporting, segment reporting and special account for assets held for sale. In India, various regulatory authorities have defined Small and medium-sized entities, standard define SMEs are entities that do not have public accountability, and publish general purpose financial statements for external users. A global financial reporting language will bring the following benefits to SMEs. a) Understanding the global financial reporting language for companies from different jurisdictions around the world to explore the possibility of cross border acquisitions and simplifying inbound and outbound investments. b) Global recognition will improve both transparency and comparability to SMEs c) SMEs will have an opportunity to attract talented finance people.

Salient Features of IFRS for SMEs

a. **Presentation of Financial statements** - Under the IFRS for SME, if the change in equity is only a result of profit or loss, payment of dividends, correction of prior period errors or due to changes in accounting policies, a combined statement of income and retained earnings can be presented instead of a separate Income statement and Statement of changes in equity. b. **Financial Instruments**- The financial instruments recognition and disclosure policies under IFRS for SME have been simplified considerably. Under full IFRS, IAS 39 distinguishes four measurement categories of financial instruments them being;

financial assets/liabilities at fair value through profit or loss, held to maturity investments, loans and receivables, available for sale financial assets. c. **Property, Plant & Equipment and Investment Property**- Under the full IFRS, entities may opt to use the revaluation model for Property Plant and Equipment (PPE) where assets are carried at fair value, or using the cost model, depending on the accounting policy adopted. Performing such revaluations regularly is costly in terms of time, money and skill. Taking this into consideration, the IFRS for SME recognizes assets at cost less accumulated depreciation. The revaluation model is not permitted. d. **Borrowing Costs**- Under the IFRS for SME, all borrowing costs are charged to the income statement, during the year in which they are incurred, even if it is directly attributable to the acquisition, construction or production of the asset in concern. The IFRS for SMEs does not allow for the capitalization of borrowing costs, unlike the full IFRS. e. **Intangible Assets**- As per the full IFRS, all research costs are written off, but development costs incurred after the project is deemed commercially viable can be capitalized. However in IFRS for SMEs, all research and development costs both are written off in the period in which they are incurred. Further, under the full IFRS, intangible assets that are considered to have indefinite useful lives are not amortized and are subject to mandatory detailed annual impairment testing. But, under IFRS for SME, intangible assets including goodwill are considered to have finite lives, and are amortized over their useful lives. If the useful life cannot be estimated, the lifespan is presumed to have a maximum amortization period of 10 years.

Process of Adoption of IFRS for SMEs: Based on the recommendation made by the Task Force and on the basis of outcome of discussions and public opinions on IFRS adoption procedure, a three step process was laid down by the Accounting Professionals in India. This three steps IFRS adoption procedure can be summarized as Step I: IFRS impact assessment -In the first step, the firm will begin with the assessment of the impact of IFRS adoption on Accounting and Reporting Issues, on systems and processes, and on Business of the firm. The firm will then identify the key conversion dates and accordingly an IFRS training plan will be laid down. Once the training plan is in place, the firm will have to identify the key Financial Reporting Standards that will apply to the firm and also the differences among current financial reporting standards being followed by the firm and IFRS. The firm will also identify the loopholes in the existing systems and processes. Step II: Preparations for IFRS implementation- This step will carry out the activities required for IFRS implementation process. It will begin with documentation of IFRS Accounting Manual. The firm will then revamp the internal reporting systems and processes. IFRS 1 which deals with the first time adoption of IFRS will be followed to guide through the first time IFRS adoption procedure. To make the convergence process smooth, some exemptions are available under IFRS 1. These exemptions are identified and applied. To ensure that



the IFRS are applied correctly and consistently, control systems are designed and put in place. Step III: Implementation- The third step involves actual implementation of IFRS. The first activity carried out in this phase is to prepare an opening Balance Sheet at the date of transition to IFRS. A proper understanding of the impact of the transition from Indian Accounting Standards to IFRS is to be developed. This will follow the complete application of IFRS as and when required. First time implementation of IFRS requires lot of training and some difficulties may also be experienced. To ensure a smooth transition from Indian Accounting Standards to IFRS, Continuous training to staff and addressing all the difficulties that would be experienced while carrying out the implementation is also required. Benefits of IFRS for SMEs adoption in India: 1. IFRS for SMEs will improve the financial reporting overall. 2. IFRS facilitates better decision making and efficient functioning of the firm. 3. IFRS for SMEs ensures creditability and comparability of financial statements. 4. IFRS for SMEs will improve access to international capital markets. 5. IFRS for SMEs will enhanced brand value and Easier Global Comparability. 6. IFRS for SME is a globally recognized standard, and when applied correctly would allow financiers to better assess the company's performance and risk, as well as provide better confidence regarding the company, reducing barriers to access to finance. 7. Implementation of IFRS in India would result into the reduction in cost of compliance. 8. IFRS for SMEs is very simple to understand and adopt. the IFRS for SME is a simplified version of the full IFRS. However there are some key differences between the IFRS for SME and the full IFRS, which the company would want to consider prior to implementing the standard.

Insight into IFRS for SME

High level comparison of full IFRS and IFRS for SME		
Topic/area	Full IFRS	IFRS for SMEs
Scope	Applicable by all entities.	(Section 1) Applicable only for entities that are not publicly accountable, and publish general purpose financial statements.
Financial statements	(IAS 1) Full set of statements must be prepared, including Income Statement, Balance Sheet, Statement of Changes in Equity and Cash flow Statement	(Section 3) A combined statement of income and retained earnings can be prepared, and the statement of changes in equity can be avoided if certain conditions are met.
Financial instruments	(IAS 39) Four measurement categories; being financial assets/liabilities, held to maturity investments, loans & receivables and available for sale financial assets.	(Section 11, 12) Two basic sections, one for basic instruments (receivable, payables and other basic instruments) and another for complex financial instruments
Property, plant and equipment	(IAS 16) Can be valued at cost-less-accumulated depreciation model, or revaluation model.	(Section 17) Revaluation model not permitted. Valued at cost-less-accumulated depreciation model.
Investment property	(IAS 40) Can recognise at either cost or fair value.	(Section 16) Can be carried at fair value if fair value can be measured without undue cost or effort to the

		management. Otherwise treated as regular PP&E.
Borrowing costs	(IAS 23) Borrowing Costs can be capitalised if they meet certain criteria	(Section 25) Borrowing costs cannot be capitalised and have to be charged to the income statement in the period they are incurred.
R&D costs	(IAS 38) Development costs after the project is deemed commercially viable can be capitalized	(Section 18) All research and development costs have to be written off in the period in which they are incurred
Employee benefits	(IAS 19) Actuarial gains/losses can be amortised over the expected remaining working years of the employee. Use of actuarial benefit valuation is required	(Section 28) Simplifications can be made if actuarial valuation cannot be made without undue cost or effort to the management Actuarial gains/losses have to be charged to the income statement in the year in which they arise

Relationship between IFRS for SMEs with GAAP: A number of significant difference and minor difference between IFRS for SMEs and Indian GAAP exist with regard to recognition. Some important difference are 1) Frame work of IFRS for SMEs is very simplified, structure and make accounting requirement less complex and reduce the cost effort required while producing financial statements when compare to Indian GAAP. 2) IFRS for SMEs has few and less disclosure requirements compare to Indian GAAP. 3) IFRS for SMEs is silent about the concepts of capital maintenance and its impact on financial statements of SMEs whereas under Indian GAAP certain concepts of capital maintenance, revaluation or restatement of assets and liabilities giving rise to increase/decrease in equity. 4) Section 3 of IFRS for SMEs Financial Statement Presentations presumes that fair presentation of financial statements whereas Indian GAAP frame work speaks about true and fair presentation and 5) Finally the IFRS for SMEs are simplifier than those in Indian GAAP and simplification might make the standard more attractive to financial statement preparer. Challenges in IFRS implementation in SMEs in India: In India the availability of accounting profession is rare in nature. Population having degree of the chartered accountant and other professional are less knowledgeable and also charge higher fees for that. So, it is a costly affair for the SMEs in India. Other challenges are: 1) Standard setter has adopted national GAAP for SMEs - Most of the standard setter decided that existence Indian GAAP is perfect for the SMEs so there is less chance for the adoption of new IFRS and mostly it depends on regulatory body if they have adopted then it's very difficult to accept and adopt. 2) IFRS for SMEs are under study -The standards for SMEs by IFRS are not still ready for implementation as there is high requirement for training. IFRS has taken step and provide enough training session for the IFRS aspect, but still this is not enough as SMEs have less experienced people and resources for the adoption of IFRS in India. 3) Work at local market - The SMEs which are working at local market why the will go for the IFRS adoption as they are raising fund from India

only and only Indian investors are investing in that local level SMEs so no need to prepare the books of account as per the IFRS. 4) Cost aspect - Most of the companies are prepared their report on time by hard and tough working if they want to adopt IFRS then there is requirement of Initial high cost, change in the process, people and technical aspect. It requires both the cost time cost and financial cost.

Recommendations and Suggestions: IFRS must complete the criteria for the SMEs perfectly. The balance sheets prepared under IFRS tends to be more useful due to its layout and the consistency, and the level of complexity compared to GAAP that tended to be more detailed. Need to educate chartered accountants. IFRS should be implemented in SMEs in India in different phases with flawless instruction in form of "Help center" as training provided by them is not enough.

Way forward: There are many benefits to entities that are entitled to use the standard, if they opt to do so. However they should perform a comprehensive Gap Analysis Study to assess the quantitative impact on the Financial Statements and the impact on disclosures. There are many positive developments in the IFRS for SME, when compared to the full set of IFRS in the perspective of a small or medium sized enterprise. An IFRS for SMEs has clear benefits for investors, lenders and those seeking to raise finance through the transparency afforded by a consistently applied global set of financial reporting standards. It will also ease transition to full IFRS for growing entities once they become publicly accountable. Since most SMEs aspire to eventually grow into large entities, it would be prudent to comply with the IFRS requirement that is unique to SMEs. In doing so, they can establish sound practices in financial reporting that adheres to global standards. In the long run, this will ease their transition from being a small or medium sized enterprise to a large player in any industry.

Conclusion

IFRS are emerging as the primary accounting language of the world. India is joining a league of 100 plus countries by announcing the convergence of Indian GAAP with IFRS with effect from April 2011. The use of IFRS in India would have significant impact on key stakeholders by presenting both benefits as well as costs. The cost of implementing IFRS should be taken as challenges or opportunities in order to encounter them in the right spirit to ensure smooth convergence with IFRS. Adoption of IFRSs by Indian companies is going to affect a number of items of their financial statements including their profitability and financial strength. Adoption of IFRS process will have a clear impact on financial position indicators of a company. More so the impact will reflect relatively more on those items where fair valuation concept of IFRSs is applicable. Adoption of IFRS by Indian companies is also going to have a favorable impact on the confidence of the investors. They could be able to analyze the financial position of the companies much more accurately due the strict reporting and disclosure requirements of IFRSs. The financial information delivered by the statements prepared under IFRS is considered to be of the highest quality therefore it is also going to have a

favorable impact on the confidence level of the users of the financial statements whether they are investors, auditors, students, stake holders, institutions, accountants, legal firms or any academicians; all accept the reliability of the financial statements prepared under IFRSs. Thus the good will of the reporting entity would also increase. Compared to full IFRS and current Indian GAAP, the IFRS for SMEs is a real gem.

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