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RESEARCH ARTICLE

**IFRS: AN IMPERATIVE NEED FOR FINANCIAL REPORTING FOR
SMEs IN INDIA**

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ABSTRACT

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The 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. Major economies of the world such as United States of America, China, Canada etc. has converged with the International Financial Reporting Standards with their respective local GAAP. India has also converged with the International Financial Reporting Standards for the reporting and presentation of transactions with effect from 1st April 2011. The adoption of the International Financial Reporting Standards surely will ensure uniformity, comparability and reliability of the financial reporting across the world. The intend 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.

Introduction

Accounting is the backbone of the business world. After all, accounting was created in response to the development of trade and commerce. The concepts of assets, liabilities, and income and the need to reconcile these areas is still the basis for all accounting functions today. Accounting gives us the financial view of the business in order to make solid decisions about the current status or projected future health of business. Every business needs to keep track of basic accounting. One of the factors that determine the performance of business organizations is effective use of accounting and financial management reports. Accounting gives us the financial snapshot of the enterprises in order to make decisions about the current status or projected future health of the enterprises.

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.

The “accountability” part of the accounting process:

Businesses need to be held accountable for the methods they use to run a business because the potential for greed, theft, and dishonesty exist in every business. There are specialized areas of accounting, that when correctly enforced, eliminate the possibility for fraud. Auditing and income taxation, when used correctly, force business to account for all business income, transactions, and transfers, and then to pay their fair share of the tax burden. The catch here is that the principles must be correctly enforced.

Accounting is the conscious of the business world. When handled with care and with respect, it performs as expected. When abuse occurs, and the system is circumvented or overridden because of dishonesty and greed, it doesn't work correctly. Accounting is much like all other systems in place, they are only as good as the people using them.

OBJECTIVES OF THE STUDY:

- 1) To understand the better knowledge on IFRS in Indian Context.
- 2) To discuss the benefit of adoption and challenges for adoption of IFRS.
- 3) To compare framework of IFRS for small and medium enterprises with Indian GAAP.
- 4) To know the features of International Financial Reporting Standards for Small and Medium Enterprises.
- 5) To study the issues and challenges faced by SMEs in the process of adoption of IFRS in India.

METHODOLOGY OF THE STUDY

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 FOR 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.

IFRS : Introduction

In almost all countries a significant part of the economic activity and output comes through the small and medium sized enterprises (SMEs). Although they are much smaller compared to listed, multinational conglomerates, SMEs are a vital component in the economy of any country, even in developed countries. They are completely different in terms of funding structure, reporting requirements and stakeholder expectations. Thus the financial reporting requirements for SMEs also vary considerably. However, the framework for financial reporting has thus far been a general set of accounting standards to be used by both, the SMEs and larger organisations.

And as such, the resources required to report under the full IFRS have a considerable impact, even for large organisations. The implementation of the full IFRS requires considerable management time, training of staff, and use of external specialist consultants to ensure full compliance with the standard. This burden is too heavy for most SMEs to bear.

With this in mind, the International Accounting Standards Board (IASB), created IFRS for SME, a set of standards to be used by small and medium sized enterprises. IFRS for SME is simplified to fit the reporting needs of SMEs, keeping in mind the skills they have and the level of costs they can afford. It aims to bring a set of globally accepted reporting standards, specifically suited for SMEs.

Who is it for?

Different countries adopt different definitions of what an SME is. However 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, or it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses.

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.

IFRS FOR SMEs

The International Accounting Standards Board (IASB) has issued International financial reporting standards for use 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 is likely to 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.

Some salient features of IFRS for SMEs

a. Financial statements presentation

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

Being a complex area by nature, 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. However if the assets are recognized at fair value, continuous revaluations need to be carried out. 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. Although this reduces the burden of complex computations to quantify the borrowing cost that could be capitalized, some entities disfavor this treatment due to the quantitative effect on the size of the asset base, as well as the effect on the Income statement. For example in some industries, such as real estate, expensing borrowing in the year in which they are incurred may lead to greater volatility in earnings.

d. 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. Moreover, impairment testing is required only when there is an indicator of impairment. It can be observed here that impairment testing is not mandatory, reducing the burden on entities for annual impairment testing.

e. Employee Benefits- Defined Benefit Plans

Under IAS19, actuarial gains or losses can be recognized immediately or be amortized over the expected remaining working years of the participating employees. The use of actuarial benefit valuation (Projected unit credit method) is required for calculating the defined benefit obligation. However under the IFRS for SMEs, entities are required to immediately recognize the expense and split it into different components. The circumstance driven approach is applicable, which means actuarial valuation method could be used if the information needed to perform the valuation is available, or can be obtained without

undue cost or effort. If not, simplifications are permitted in which, future salary progression, future service or possible mortality during an employee's service period is not considered.

The best things come in small packages and in this respect the IFRS for short. If a topic is not covered in the standard there is mandatory default to full IFRS. Instead, preparers have to think. The IFRS for SMEs contains concepts and pervasive principles for financial reporting, which should guide preparers to a good answer. Disclosure beyond that required by the standard may then be needed to present a true and fair view. So, the key issue will be how the IFRS for SMEs compares with existing Indian GAAP. In many areas, particularly where the requirements would not constitute a change to current Indian accounting practice, the comparison will favour IFRS for SMEs, which deals with topics in a relatively short and straightforward manner. In other areas where the IFRS for SMEs is not consistent with existing Indian practice, the debate will rage. These areas include:

Taxation: IFRS for SMEs is aligned with the current exposure draft to improve IAS 12, 'Income Taxes'. In principle, provision will be made for the current and future tax consequences of transactions and other events reflected in the financial statements.

IAS 12 is based on balance sheet approach where the temporary differences arise through balance sheet and reverse through balance sheet. Indian AS 22, 'Accounting for Income Tax' is based on profit and loss account approach. This may result in more deferred tax assets and liabilities than the current provision in Indian AS 22.

Financial instruments: IFRS for SMEs allows its followers to use IAS 39, Financial Instruments, or the simplified provisions in the standard. The latter is essentially an amortized cost model, with annual checks for impairment. The exception is for shares that are traded publicly of whose fair value can otherwise be measured reliably. They must be included at fair value and the difference taken directly to the income statement. In practice the financial

instruments' rules are unlikely to be too contentious across India.

Compared to IAS 39 and its Indian equivalent, AS 30-Financial Instruments, the SME provisions will have the merit of being capable of comprehension, with some time investment, to reasonable accountant.

IFRS Adoption Procedure

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 follows:

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

1. Based on user needs

The need of the users of the financial statements of an SME is quite different to that of a publicly accountable entity. A publicly accountable entity's financial statements is purposed to serve a wide group of users such as analysts, government bodies and regulators, credit rating agencies, lenders, suppliers, customers institutional and individual shareholders, and hence full IFRS attempts to provide information needs of such complex users.

In contrast, financial statements of a small or medium sized entity would be quite different and comprise of much smaller user groups such as the owners (who in most cases would be the management), tax authorities, and lenders. The IASB has taken this into consideration when during the design stages, and has tailored the standard to this focused user group needs.

The IASB has recognized that the complexities of a family business are also different to the complexities of a publicly accountable entity. And because IFRS for SME are globally accepted accounting standards, they could benefit many stakeholders if they are applied correctly.

2. Reduces barriers related to accessing finance

One of the biggest challenges SMEs face is in the access to finance. The main reason for this is financiers, (whether banks or other financial institutions), who have difficulties in relying on the information provided by the financial statements due to the lack of a clear, and coherent accounting principle application. The 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. IFRS for SMEs creates a framework for a more clear and comprehensive comparison of entities that apply the standard.

3. Reduced compliance cost

The IFRS for SME has removed unnecessary topics (i.e. earnings per share, segmental information, complex risk disclosures), and has reduced compliance requirements that place an unnecessary burden on the preparers. Such measures, for example include, simplification of recognition principles of certain items, revaluation of assets being made non-mandatory and allowing for gratuity to be provisioned using simple techniques with whatever information that is available. These measures remove some of the more cumbersome requirements of full IFRS, making compliance a lot less burdensome.

4. Simplification

The IASB are aware of the fact that the resources and the skills that the SMEs are able to dedicate to interpret and apply accounting standards is limited. As a result the standard is simplified considerably in comparison to the full IFRS. This is apparent, as the IFRS for SME contains only 230 pages, whereas the full standard contains over 1800 pages, excluding the interpretations!

Overall, 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

COMPARISON OF 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 discussed as below.

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.

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:

a) 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.

b) 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.

c) Work at local market

The SMEs which are working at local market why they 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.

d) 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.

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

Adoption of IFRSs by Indian companies is going to affect a number of items of their financial statements including their profitability and financial strength. IFRS will affect Operating Profit Margin, Return on Equity, Current Ratio, Earnings Per Share, Return on Capital Employed, Debt- Equity Ratio, Asset- Turnover Ratio, Net Profit Margin Ratio and Depreciation. 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. Thus initially at the time of adoption the companies must prepare themselves for an impact on financial statements. Adoption of IFRSs 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. Under IFRSs the companies are also required to report all their assets on fair value basis so the investors can evaluate the true financial position of the organizations much more accurately. The overseas investors who want to invest their capital in Indian companies would also feel more confident in investing.

The financial information delivered by the statements prepared under IFRSs 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.

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