ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) FOR SMALL AND MEDIUM-SIZED ENTERPRISES (SMEs): PROBLEMS AND CHALLENGES

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SYNOPSIS

The International Accounting Standards Board (IASB) has pursued a strong agenda to develop a simplified set of International Financial Reporting Standards (IFRS) for small and medium-sized enterprises (SMEs). IFRS for SMEs published in 2009 was derived from full IFRS with significantly reduced recognition and measurement principles, guidance and disclosure requirements in order to satisfy the accounting information needs of the users of SME financial statements.

The aim of this thesis is to undertake a comprehensive examination of the conceptual and practical issues in the convergence of IFRS for SMEs and suggest possible ways to address these issues. In particular, the thesis undertakes the following four research projects under the theme of problems and challenges in implementing IFRS for SMEs: (1) critically reviews IFRS for SMEs, including the development and implementation process of the standards; (2) examines whether accountants are able to distinguish between the recognition and measurement principles of full IFRS and IFRS for SMEs when they exercise professional judgment; (3) investigates the impact of the reduced guidance in IFRS for SMEs on the professional judgment of accountants; and (4) investigates whether users of SME financial statements benefit from a simplified set of IFRS for SMEs.

This thesis employs exploratory and empirical research methods to examine the controversial issues in the adoption of IFRS for SMEs. The findings of this thesis provide evidence that IFRS for SMEs have been a challenge for non-publicly accountable entities to adopt and there are several conceptual and practical issues with IFRS for SMEs. In particular, the thesis provides evidence that accountants are unable to choose accounting treatments that best reflect the economic substance of a transaction when the recognition and measurement requirements are different across full IFRS and IFRS for SMEs and when guidance is significantly reduced from IFRS for SMEs. This thesis also provides evidence that users perceive disclosure of IFRS for SMEs to be decision useful but they do not regard that the simplification significantly enhances their decision making.

STATEMENT OF ORIGINALITY

This is to certify that the work presented in this thesis has not been submitted for a higher degree to any other university or institution. The source of information used and the extent to which the work of others has been utilised is acknowledged in the thesis. This thesis has obtained the approval of the Ethics Committee at Macquarie University for the relevant projects that have been completed [Reference Numbers: 5201300592, 5201400850, and 5201401179].

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Dinuja Perera

DEDICATION

This thesis is dedicated to the memory of my beloved husband, Chandana Kavan Fernando, who devotedly encouraged and supported me in my career pursuit, but who unexpectedly passed away before I commenced my doctoral studies.

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EXPLANATION OF TERMS AND ABBREVIATIONS USED IN THIS THESIS

AASB	Australian Accounting Standards Board
ABN	Australian Business Number
ABS	Australian Bureau of Statistics
ACA	Associate Chartered Accountant
ACCA	Association of Chartered Certified Accountants
AcSB	Accounting Standards Board in Canada
ADB	Asian Development Bank
AICPA	American Institute of Certified Public Accountants
ANOVA	Analysis of Variance
APEC	Asia Pacific Economic Corporation
ASC	Singapore Accounting Standards Council
ASPE	Accounting Standards for Private Enterprises
CIMA	Certified Institute of Management Accountants
CPA	Certified Public Accountants
DGRV	German Cooperative and Raiffeisen Confederation
DIISR	Department of Innovation Industry, Science and Research
EC	European Commission
ED	Exposure Draft
EFRAG	European Financial Reporting Advisory Group
EIU	Economist Intelligent Unit
FCA	Fellow Chartered Accountant
FRF	Financial Reporting Framework
FRS	Financial Reporting Standard
GAAP	Generally Accepted Accounting Principles
GDP	Gross Domestic Production
GPFI	Global Partnership for Financial Institutions
GPFS	General Purpose Financial Statements
HKAS	Hong Kong Accounting Standards
HKFRS	Hong Kong Financial Reporting Standards
HKICPA	Hong Kong Institute of Certified Public Accountants
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IBSL	Institute of Bankers of Sri Lanka
ICAA	Institute of Chartered Accountants Australia
ICAEW	Institute of Chartered Accountants of England and Wales

ICAS	Institute of Chartered Accountants of Scotland
ICASL	Institute of Chartered Accountants of Sri Lanka
IFC	International Finance Corporation
IFRIC	International Financial Reporting Interpretation Committee
IFRS	International Financial Reporting Standards
LCB	Licensed Commercial Banks
MBA	Master of Business Administration
MED	Ministry of Economic Development
METI	Ministry of Economy, Trade and Industry
MFR	Currency of Maldives - Maldivian Rufiyaa
MOI	Ministry of Industries
MSME	Micro, Small and Medium-sized Enterprises
NAICS	North American Industry Classification System
NU	Currency of Bhutan - Ngultrum
OECD	Organization for Economic Co-operation and Development
PPE	Property, Plant and Equipment
PWC	PriceWaterhouseCoopers
PWGSC	Public Works and Government Services of Canada
RDR	Reduced Disclosure Regime
SAC	Statement of Accounting Concepts
SAICA	South African Institute of Chartered Accountants
SBA	Small Business Administration
SBC	Small Business Corporation
SEC	Securities Exchange Commission
SFRS	Singapore Financial Reporting Standards
SLFRS	Sri Lanka Financial Reporting Standards
SMEIG	Small and Medium-sized Enterprises Implementation Group
SMEs	Small and Medium-sized Enterprises
UAE	United Arab Emirates
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
US	United States of America
USD	US Dollar
USTR	United States Trade Representative

CHAPTER 1

Overview of the Thesis

1.0 INTRODUCTION

The International Accounting Standards Board (IASB) has pursued a strong agenda in recent years to develop a simplified set of International Financial Reporting Standards (IFRS) for small and medium-sized enterprises (SMEs), particularly for non-publicly accountable entities. IFRS for SMEs published in 2009 was derived from full IFRS with significantly reduced recognition and measurement principles, guidance and disclosure requirements in order to satisfy the accounting information needs of the users of SME financial statements (IASB, 2009a). In the history of the accounting standard setting process of the IASB, IFRS for SMEs was the first set of standards that was formulated for SMEs. As such, IFRS for SMEs has been receiving great attention and the accounting regulatory bodies, including the IASB, are continuously monitoring its adoption and the successful implementation of the standard across the globe.

Small and medium-sized enterprises (SMEs) play a vital role in economic and social development in developed and developing economies. It has been recognized that the SME sector is the largest employment provider in many countries, particularly in terms of new job creation. Furthermore, the contribution of SMEs to the economic output, technology and innovation has also been widely identified (Chen, 2006; OECD, 2005; Reddy, 2007). The IASB believes that the adoption of IFRS for SMEs will enhance SMEs' access to international finance through harmonised and high quality financial information (IASB, 2009a). Therefore, this changeover is expected to be a major breakthrough for SMEs if the perceived benefits are appropriately recognised by countries and they adopt IFRS for SMEs.

So far, seventy plus countries have adopted or expressed interest in adopting IFRS for SMEs for all their non-publicly accountable entities (IFRS Foundation, 2015a). However, countries opposing the adoption of IFRS for SMEs, in particular, major developed countries raise concerns that the implementation of a differential reporting framework appears to be controversial and problematic for SMEs in many jurisdictions. The excessive departure from accounting policies and requirements in full IFRS is regarded as a significant barrier for the adoption of IFRS for SMEs (Australian Accounting Standards Board (AASB), 2010a; European Commission (EC) Explanatory Memorandum, 2011).

Importantly, the degree to which IFRS for SMEs have been accepted or rejected by countries creates several arguments.

Significant attention has been received in the international accounting literature on the controversies and challenges that endangered the convergence of international accounting standards (see Alp & Ustundag, 2009; Chand, Patel, & Patel, 2010; Doupnik & Richter, 2003; Wong, 2004; Wustemann & Wustemann, 2010). Irrespective of the complex or simplified status of the standard, prior studies in general reveal that the implementation of IFRS by individual jurisdictions appears to be complex and challenging. Therefore, it is timely and essential to examine the financial reporting transformations of non-publicly accountable entities and SMEs when applying IFRS for SMEs (Evans et al., 2005). More specifically, the possible transition issues that may arise when moving from local GAAP/full IFRS to IFRS for SMEs, such as arguments against "differential reporting", cost-benefit considerations in adopting IFRS for SMEs, and technical issues inherent in the recognition and measurement principles of the standard, have been regarded as challenging issues which have not been addressed in depth so far in the literature (AASB, 2010a; Evans et al., 2005; Miihkinen, 2014; van Mourik & Walton, 2013).

This thesis undertakes a comprehensive examination of the conceptual and practical issues in the implementation of IFRS for SMEs. The first paper critically reviews IFRS for SMEs, including the development and implementation process of the standards. While many countries have adopted IFRS for SMEs, with or without modifications, there are still a number of prominent countries who have yet to adopt this set of standards. This study will provide evidence as to why IFRS for SMEs has presented a challenge for non-publicly accountable entities; and identifies conceptual and practical issues in the implementation of IFRS for SMEs. The analyses and insights provided by this study will have implications for the revision of IFRS for SMEs and will assist in addressing future complications in the SME convergence process.

While the changeover to international accounting standards by SMEs continues to progress, limited research has been conducted to empirically test the impact of principles-based IFRS for SMEs on the judgment and decision making process of accountants. There is an extensive use of professional judgment in a principles-based approach to IFRS (Hodgdon, Hughes, & Street, 2011; Larson & Street, 2011), and professional judgment is therefore regarded as a vital yet controversial issue in its current context (Alp and Ustundag, 2009; Chand et al., 2010; Chand, Patel, & White, 2015). Motivated by the current gap in extant SME accounting literature and its great importance to accounting regulators and practitioners, the second and third papers of this thesis empirically examine the challenges posed by IFRS for SMEs when accountants exercise professional judgment.

The second paper provides empirical evidence on how well accountants are able to distinguish between the recognition and measurement principles for full IFRS and IFRS for SMEs, independent of their prior understanding of full IFRS when they interpret and apply IFRS for SMEs. The major prediction of the prior belief effect is the likelihood that prior beliefs in interpreting and applying the full set of IFRS influence the professional judgment of accountants when they apply IFRS for SMEs. The intent is to identify accountants' subsequent decision bias (confirmation or disconfirmation) with respect to their prior beliefs on full IFRS. The findings of this study will be of paramount significance, because decision bias often results in increased cost (particularly the cost of inaccurate financial information), thus the findings will be helpful in assisting accountants to avoid such costs yet better represent high quality and unbiased financial information.

The ambiguity associated with less guidance in IFRS for SMEs compared to full IFRS, and the latitude inherent in IFRS for SMEs, may pose challenges when accountants exercise professional judgment. This will have great impact on the consistent interpretation and application of the standard. The third paper examines the relationship between the availability of guidance in the standard and accountants' ability to draw reasonable judgments relating to an accounting issue. The empirical evidence of this study will assist in explaining whether the reduced guidance has a significant impact on the judgment of accountants when they interpret and apply IFRS for SMEs, and will provide evidence as to whether there is consistent interpretation and application of IFRS for SMEs. The findings of this study will provide important insights to accounting regulators while adopting IFRS for SMEs and when making amendments to the standards.

There is an increasing demand for more empirical evidence on the decision usefulness of financial reporting information of SMEs, because the little extant literature that exists on the decision usefulness of SME financial information is contradictory (Allen & Cote, 2005; Dang-Duc, 2011; Kitindi, Magembe, & Sethibe, 2007; Kwok, 2002; Son, Marriott, &

Marriott, 2006). The fourth paper examines how users perceive the decision usefulness of the financial reports prepared under IFRS for SMEs. This study aims to fill the gap in existing accounting literature and to add new insights on the decision usefulness of the measurement concepts of IFRS for SMEs. This research will centre on the rationale behind the differential reporting framework introduced by the IASB. The findings of this study will be of great interest to standard setters, accounting regulators and users of SME financial reports.

This thesis contributes to the international accounting literature, highlighting both the inherent complexities in the adoption of IFRS for SMEs and the problems in interpreting and applying these standards in a consistent manner. The findings of this thesis will have implications for revising IFRS for SMEs and will assist in addressing future complications in the adoption of IFRS for SMEs.

This chapter is organised as follows. Section 1.1 presents the background of the thesis. Section 1.2 outlines the aim and objectives, followed by an overview of all four research projects carried out in this thesis. Section 1.3 broadly describes the contributions of this thesis. The final section provides an overview of how the remainder of the thesis is organised.

1.1 BACKGROUND

The concept of international convergence of accounting standards dates back to 1950s where the economic integration and cross-border trading began to thrive post-World War II (Financial Accounting Standards Board (FASB), 2013). The world-wide interconnectedness in businesses has grown immensely in the twentieth century, with globalization steering a rapid increase in international trade, international investments and capital flows across borders (Carlson, 1997; FASB, 2013). A gradual increase in cross-border activities has created more complex business transactions and businesses continue to seek for reliable, consistent and comparable business information (Purvis, Gernon, & Diamond, 1991). The International Accounting Standards Committee (IASC), subsequently reorganized into the International Accounting Standards Board (IASB) in 2001, was proceeding towards developing a unified set of high quality international accounting standards that would satisfy accounting information needs of global economies (Carlson, 1997; FASB, 2013; Rodrigues & Craig, 2007). Since then, the International Financial Reporting Standards (often called 'full IFRS') came into effect and many prominent countries commenced their accounting convergence process with IFRS.

There was a growing concern that IFRS had created financial reporting standards which were overly complex, especially for SMEs (Association of Chartered Certified Accountants (ACCA), 2009). The IASB has been working on designing a simplified version of the full set of IFRS which satisfies the financial reporting requirements of SMEs. The Exposure Draft of IFRS for SMEs was issued for public comment in October 2007 and after extensive consultation and field testing, the final set of IFRS for SMEs came into effect in July 2009, entitled to be applied by entities that do not have public accountability, but prepare general purpose financial statements for external users (IASB, 2009a). IFRS for SMEs was an important step in the convergence process of international accounting standards.

Unveiling a simplified set of international accounting standards for SMEs has been acknowledged as a major breakthrough for SMEs. Many regarded the issuance of IFRS for SMEs as timely and essential. SMEs have an eminent position in the global economy and represent approximately 95% of businesses around the world (IFRS Foundation, 2012a). More specifically, SMEs are regarded as the key drivers of employment creation, economic output and economic development in many developed and developing economies (Chen, 2006; Organization for Economic Co-operation and Development (OECD), 2005; Reddy, 2007).

Many countries are gradually adopting IFRS for SMEs and it is reasonable to accept that IFRS for SMEs is a response to strong international demand for a simplified global set of financial reporting standards for SMEs. However, there are several controversial issues pertaining to the implementation of IFRS for SMEs, as reported by prominent accounting regulatory bodies at individual jurisdiction levels. In particular, the divergence between full IFRS and IFRS for SMEs (i.e. the differential reporting framework) may pose significant challenges in implementation, interpretation and application across various jurisdictions. Moreover, several arguments have been made against differential reporting that the differences between IFRS for SMEs and full IFRS should be allowed, mainly with regard to disclosure requirements rather than with recognition and measurement principles (Evans et al., 2005). For this reason, major developed countries such as Australia, Canada and New Zealand still favour the reduced disclosure approach for their SMEs, keeping the recognition and measurement principles identical to full IFRS.

The ultimate success of IFRS for SMEs will depend on the extent to which users, preparers, and auditors believe that the standard meets their needs (Epstein & Jermakowicz, 2008, p. 44). Despite the debate over the differential reporting framework introduced by the IASB, to date there has been limited empirical evidence to demonstrate preparers' and users' acceptance of the stand-alone set of IFRS for SMEs. IFRS in general use a more principles-based approach that provides accountants with a conceptual basis to use in exercising judgment. Particularly, the knowledge and understanding about judgment and decision making behaviour of accountants under these circumstances is lacking. Moreover, there is extensive literature on auditor judgments (see Ashton, 1992; Budescu, Peecher, & Solomon, 2012; Fukukawa & Mock, 2011; Nelson & Tan, 2005; Ng & Shankar, 2010), however, very little is known about financial statements preparers' judgments who are consistently involved in various judgmental tasks that significantly influence financial reporting. Scholars have also emphasised the need for more studies on preparer judgments (see Psaros & Trotman, 2004; Psaros, 2007 for a review).

To fill this void, the behavioural accounting research approach is used in this thesis to provide evidence on preparers' and users' readiness to accept IFRS for SMEs as a stand-alone set of standard. As explained by Godfrey, Hodgson, Tarca, Hamilton, & Holmes (2010), behavioural accounting originated from other disciplines; namely sociology, psychology, and organisational theory and often asks the question: "how do people actually use and process accounting information?" (p. 446). A behavioural accounting research approach is therefore vital in the current context to present a factual response to the question of how accountants perceive IFRS for SMEs and how effectively they apply IFRS for SMEs to process accounting information in ways that are beneficial for the decision usefulness of users.

One of the major challenges of IFRS for SMEs on practising accountants is the substantial deviations in accounting policies, principles and accounting treatments of full IFRS. In such circumstances, the application of judgments are susceptible to bias towards accounting policies and principles that have traditionally been applied in full IFRS. This thesis uses the concept of confirmation bias which originated from psychology to analyse this issue. Confirmation bias has been extensively tested in tax and audit engagements and the literature consistently implies its existence (Cloyd & Spilker, 1999, 2000; Hatfield, 2000, 2001; Wheeler & Arunachalam, 2008). However, evidence on the presence of confirmation bias in preparers' reporting judgments is lacking.

Another major challenge for practising accountants is the significantly reduced guidance in IFRS for SMEs and the requirements pertaining to the fallback to full IFRS in the absence of guidance under IFRS for SMEs. Critics contend that the reduced guidance may have a significant impact on impairing judgment accuracy and consistency (Ahmed, Neel, & Wang, 2013). In the principles-based approach to IFRS, the availability of guidance on improving reporting judgments has been widely discussed however, it has been generally overlooked in literature. Limited literature stresses the importance of decision aids such as implementation guidance in improving the judgment and decision making behaviour of accountants (see Mala & Chand, 2014 for a review).

The decision usefulness of SME financial information for users has been a long-standing matter in the accounting literature (Dang-Duc, 2011; Son et al., 2006) and has prompted more discussions when IFRS for SMEs came into effect. In developing IFRS for SMEs, the IASB has been working on the assumption that users of SME financial statements have similar information needs. However, it is argued that no special efforts have been undertaken to ensure user participation in the due process of IFRS for SMEs. The successful implementation of IFRS for SMEs and the need for improvement cannot be envisaged if the users' perceptions of the decision usefulness of IFRS for SMEs is not well understood. As such, understanding the preparers' and users' response to the simplified IFRS for SMEs is imperative, as many countries are gradually moving towards its adoption and the IASB is continuing to monitor the success of its implementation.

1.2 AIM AND OBJECTIVES

The aim of this thesis is to undertake a comprehensive examination of the conceptual and practical issues in the convergence of IFRS for SMEs and to suggest possible ways to address these issues. The thesis has the following objectives:

- To critically review IFRS for SMEs, including the development and implementation process of the standard and to provide extensive insights into the adoption of IFRS for SMEs.
- To examine whether accountants are able to distinguish between the recognition and measurement principles of full IFRS and IFRS for SMEs when they exercise professional judgment.
- To examine the impact of the reduced guidance in IFRS for SMEs on the professional judgment of accountants.
- To investigate user perceptions of the decision usefulness of financial statements prepared in compliance with IFRS for SMEs.

Four research projects are undertaken to achieve the aforementioned objectives of the study. They are described in detail below.

Paper 1: Issues in the adoption of International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs)

This study addresses the first objective of the thesis. The objective of this paper is to critically review IFRS for SMEs, including the development and implementation processes of the standard. It begins by providing a brief background to the accounting regulatory framework for SMEs and then appraises the importance of SMEs. The study applies the framework of decision usefulness theory and the pecking order theory to evaluate issues pertaining to the development and implementation process of IFRS for SMEs.

This exploratory study identifies several issues involved in the due process and explains how these issues hinder the achievement of the objectives of IFRS for SMEs. The study also provides evidence of various complications and contentious issues related to the implementation process of the standard. In particular, the study draws attention to the barriers and inconsistencies in national legislations and reporting frameworks, the technical difficulties inherent in IFRS for SMEs and controversies over the differential reporting framework for SMEs.

The analyses and insights provided by this study will assist in addressing the complications in the adoption of IFRS for SMEs and will have implications for amending IFRS for SMEs. The study also provides important insights for prospective countries that are planning to adopt IFRS for SMEs in the future.

This paper was published in 2015 in the *Advances in Accounting, incorporating Advances in International Accounting*, Vol.31, Issue 1, pp. 165-178. An earlier version of the paper was presented at the *Accounting and Finance Association of Australia and New Zealand* (AFAANZ) Conference, Perth, Australia, 7th – 9th July, 2013.

Paper 2: Confirmation Bias in the Reporting Judgments of Accountants when Applying International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs)

This study addresses the second objective of the thesis. This study argues that when the recognition and measurement requirements are different across full IFRS and IFRS for SMEs, the subsequent reporting judgments of accountants on IFRS for SMEs may be biased towards full IFRS if accountants hold strong prior knowledge about full IFRS. Particularly, the study examines the likelihood that prior knowledge and beliefs about full IFRS (confirmation bias) influence the reporting judgments of accountants when applying IFRS for SMEs. This study also examines the likelihood that judgment justification requirements and the availability of decision aids assist in mitigating the confirmation bias that arises from prior knowledge and beliefs on full IFRS.

This study tests the relevant hypotheses using an experiment administered to 92 qualified members of the Institute of Chartered Accountants of Sri Lanka, representing both Big 4 and non-Big 4 accounting firms in Sri Lanka. The results obtained were then statistically analysed (primarily using SPSS univariate analysis).

The findings of the study support the notion that the tendency to confirm prior knowledge and beliefs about full IFRS impairs the reporting judgments of accountants when they interpret and apply IFRS for SMEs. The study further suggests that confirmation bias in judgments can be mitigated by increasing accountants' awareness of justification requirements and by using appropriately designed decision aids which contrast the differences in the recognition and measurement criteria between full IFRS and IFRS for SMEs. The results of this study provide important implications for countries that have adopted IFRS for SMEs, indicating that they need to provide appropriate training and guidelines for their accountants.

An earlier version of the paper was presented at the 50th *British Accounting and Finance Association* (BAFA) Conference, London School of Economics, London, 14th – 16th April, 2014. This paper is currently under review in a prominent accounting journal.

Paper 3: The Impact of the Reduced Guidance in International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs) on the Reporting Judgments of Accountants

This study addresses the third objective of the thesis. Given that implementation guidance is significantly reduced when compared to full IFRS, this study argues that the elimination of guidance may create interpretation difficulties and inconsistency in reporting judgments when accountants apply IFRS for SMEs. The study further argues that, in the absence of explicit guidance, the users of the standards may over rely on information contained in the examples, thus, the accuracy of the judgments may be impaired. Based on the arguments developed, the primary focus of this study is to empirically examine the effects of the reduced guidance in IFRS for SMEs on the reporting judgments of accountants. The study is also interested in examining the likelihood that the examples provided as guidance bias the reporting judgments of accountants towards the similarities presented in the examples. The relative effectiveness of explicit guidance and examples provided in accounting standards are also examined in this study.

This study tests the relevant hypotheses using an experiment administered to 148 qualified members of the Fiji Institute of Accountants, representing both Big 4 and non-Big 4 accounting firms in Fiji. The results obtained were then statistically analysed (primarily using SPSS univariate analysis).

The findings of the study support the notion that the reduced guidance in IFRS for SMEs is likely to impair the reporting judgments of accountants. Particularly, the findings indicate that accountants are unable to choose the accounting treatment that best reflects the economic substance of a transaction when there is limited explicit guidance available. The study further reveals that the examples provided as guidance are susceptible to judgmental biases. The findings of this study will be of interest to the IASB and other national accounting regulators as they continue to monitor the implementation issues and the need for any amendments to IFRS for SMEs.

Paper 4: User Perceptions of the Decision Usefulness of Financial Statements prepared in compliance with International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs)

This study addresses the final objective of the thesis. The study aims to provide empirical evidence of the decision usefulness of IFRS for SMEs from one of the main user groups of SME financial statements, namely, the banks. Considering two aspects of the simplification in IFRS for SMEs, this study examines the decision usefulness of the reduced disclosure requirements and simplified recognition and measurement requirements of IFRS for SMEs.

A questionnaire survey was conducted with 43 bank lending officers to understand the perception of bank lending officers about the decision usefulness of the reduced disclosure requirements of IFRS for SMEs on SME lending decisions. Follow-up interviews were also conducted with 19 senior bank lending officers to gain in-depth insights into the appropriateness and economic consequences of the simplification of recognition and measurement requirements of IFRS for SMEs on bank lending decisions.

The results of the study show that most of the disclosure requirements of IFRS for SMEs are found to be useful for bank lending decisions. However, the study further reveals that bank lending officers do not consider all the disclosure requirements to be equally important for their lending decisions. With regard to the simplification of recognition and measurement requirements, the findings indicate that bank lending officers have no major issues with the simplification of recognition and measurement principles, but they do not consider that such simplification significantly improves their lending decisions. The findings of this study will be of interest to the accounting regulators, including the IASB, for evaluating the decision usefulness of IFRS for SMEs.

1.3 CONTRIBUTIONS OF THE THESIS

This thesis contributes to the areas of international accounting literature and judgment and decision making literature in accounting in numerous ways.

This thesis adds to the international accounting literature by increasing the understanding of international accounting and reporting practices by means of providing evidence on current issues confronting the adoption of IFRS for SMEs. More specifically, the first paper of this thesis reveals the challenges that non–publicly accountable entities have to face when adopting IFRS for SMEs. The study also provides great insights on the issues associated with the IASB's due process of IFRS for SMEs and numerous implementation issues underlined by countries that have adopted or opposed the adoption of IFRS for SMEs. These outcomes help to broaden the understanding of international accounting convergence and the reporting practices.

This thesis also provides an important contribution to the judgment and decision making research in accounting. Even though the adoption of IFRS for SMEs has received great attention over the past few years, relatively little attention has been received so far in the accounting literature to demonstrate preparers' and users' readiness to accept IFRS for SMEs as a stand-alone set of standards. Having an understanding of preparers' judgments is also important to the accounting standard setters, including the IASB. Such understanding further provides important insights on how the judgment and decision making process of the accountants can be improved, which is eventually beneficial for numerous stakeholders.

One of the key findings of the second paper of this thesis is that the presence of confirmation bias in reporting judgments significantly impairs the judgment quality and consistency in light of the differential reporting framework introduced by the IASB. The findings further suggest that the justification requirements and decision aids can be usefully exploited to eliminate such biases. Thus, the findings of this study provide an incremental contribution to the knowledge of implications of differential reporting frameworks on the professional judgments of accountants. Overall, the findings of this study broaden the scope of the judgment and decision making literature in accounting.

The findings of the third paper provide a novel contribution to the role that implementation guidance accompanied in accounting standards can play in improving the judgment and decision making process of the accountants. This understanding is important to the accounting standard setters when evaluating the successful implementation of the standard and when shaping the optimal format for accounting standards. The findings of this thesis also provide important insights for the development of the teaching, learning and training process for accounting practitioners. A better understanding of the effects of IFRS for SMEs on the judgment of accountants is useful for designing appropriate decision aids and supportive training materials.

The fourth paper of this thesis provides vital evidence on the decision usefulness of the financial reports that are prepared in compliance with IFRS for SMEs. This study indicates that the simplified disclosure requirements are useful for bank lending decisions, however, bank lending officers prefer measurement principles to be the same across all entities regardless of the size and listed nature of the entities. The findings of this study are important, particularly to the accounting standard setters, because they provide a deeper understanding of user perceptions of the decision usefulness of recognition and measurement principles and the disclosure requirements in IFRS for SMEs.

Overall, this thesis provides important insights into the successful implementation of IFRS for SMEs by demonstrating evidence from both the preparers and the users of SME financial statements, particularly drawing evidence from countries that have adopted IFRS for SMEs. The conclusions derived from this thesis have potential policy implications for the IASB, accounting regulators at individual jurisdictions, professional accountants and accounting educators, which will be discussed at the end of each paper and summarised in Chapter 6 *Summary and Conclusions* of the thesis.

1.4 ORGANIZATION OF THE THESIS

The thesis is organised into six chapters. Chapter 1 provides an overview of the thesis. Chapters 2 to 5 comprise the four self-contained papers. Each paper is in journal article format and the relevant tables, figures and references are incorporated at the end of respective chapters and the entire bibliography is provided at the end of the thesis. The research instruments that were used to collect the relevant data for studies in Chapters 3, 4 and 5, and the letters of ethics approval obtained for each projects are attached as Appendices at the end of the thesis. Chapter 6 is the concluding chapter which summarises the findings of each of the four studies and draws appropriate conclusions and implications. The limitations of the thesis and suggestions for future research are also discussed in Chapter 6.

The details of the six chapters are as follows:

Chapter 1	Overview of the Thesis
Chapter 2	Paper 1: Issues in the Adoption of International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs)
Chapter 3	Paper 2: Confirmation Bias in the Reporting Judgments of Accountants when Applying International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs)
Chapter 4	Paper 3: The Impact of the Reduced Guidance in International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs) on the Reporting Judgments of Accountants
Chapter 5	Paper 4: User Perceptions of the Decision Usefulness of Financial Statements prepared in compliance with International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs)
Chapter 6	Summary and Conclusions

CHAPTER 2

(PAPER 1)

Issues in the Adoption of International Financial Reporting Standards (IFRS) For Small and Medium-Sized Enterprises (SMEs)

ABSTRACT

Small and medium-sized enterprises (SMEs) in various jurisdictions are currently attracting enormous attention and have also stepped into the global accounting reporting arena as a result of the introduction of International Financial Reporting Standards (IFRS) for SMEs. This study critically reviews IFRS for SMEs, including the development and implementation process of the standards. Furthermore, it applies the framework of decision usefulness theory and the pecking order theory to evaluate issues pertaining to the development and implementation of IFRS for SMEs. This study provides evidence that IFRS for SMEs have been a challenge for non-publicly accountable entities to adopt and there are several conceptual and practical issues with IFRS for SMEs. The analyses and insights provided by this study will have implications for revising IFRS for SMEs and will assist in addressing future complications in the SME convergence process.

Keywords: IFRS for SMEs, accounting convergence, non-publicly accountable entities, SMEs, financial reporting transformation

2.0 INTRODUCTION

Small and medium-sized enterprises (SMEs) in various jurisdictions are currently attracting enormous attention and have also stepped into the global accounting reporting arena as a result of the introduction of International Financial Reporting Standards (IFRS) for SMEs. While many countries have adopted full IFRS for publicly accountable entities, they were reluctant to adopt this set of complex, onerous and costly standards for non-publicly accountable entities, particularly SMEs (Dang-Duc, 2011; Fearnley & Hines, 2007; Tyrrall, Woodward, & Rakhimbekova, 2007). IFRS for SMEs was therefore an outcome of a rigorous process pioneered by the International Accounting Standards Board (IASB) to introduce a simplified version of full IFRS with significantly reduced recognition and measurement principles and disclosure requirements. IFRS for SMEs have been issued in anticipation that they will be applied by entities that do not have public accountability but who prepare general purpose financial statements for external users (IASB, 2009a).

It is important to note that the majority of entities around the world are represented by SMEs (Alp & Ustundag, 2009). Moreover, the SME sector is regarded as the backbone of many economies in both developed and developing countries. This sector makes an enormous contribution to employment creation, technological innovation and economic output (see Chen, 2006; OECD, 2005; Reddy, 2007). Prior to the introduction of IFRS for SMEs in 2009, individual jurisdictions adopted either local generally accepted accounting principles (GAAP) or full IFRS for the financial reporting purposes of non-publicly accountable entities and SMEs around the world (Alp & Ustundag, 2009; Tyrrall et al., 2007). The IASB believes that the adoption of IFRS for SMEs will possibly enhance SMEs' access to international finance through harmonized and high quality financial information (IASB, 2009a).

This movement towards the convergence of IFRS for SMEs still seems to be controversial for a number of reasons. Deloitte Touche Tohmatsu reports that "many countries are moving towards adoption of IFRS for SMEs, although it appears these countries may not have required IFRS accounting 'across the board' prior to moving to implementation" (AASB, 2010a, p. 1). In contrast, more prominent developed countries that have adopted the full set of IFRS, such as Australia, the United Kingdom, and European Union member states, have not yet adopted IFRS for SMEs.

Many countries, including Australia, are of the view that IFRS for SMEs still appear to be complex in recognition and measurement principles (AASB, 2010a). Moreover, the European Commission (EC) is of the view that the objectives of simplification and the reduction of administrative burden for SMEs has not yet been served by IFRS for SMEs (EC Explanatory Memorandum, 2011). Such concerns raised by prominent countries or regions highlight several issues for IFRS for SMEs and their implementation. The entities (non-publicly accountable entities) that are envisaged as being eligible to apply IFRS for SMEs represent more than 95 percent of all companies globally (RSM International Association, 2009). The need to develop an appropriate regulatory framework and to enable comparable accounting information to be provided by SMEs is considered to be highly important. Therefore, it is vital to examine the conceptual and technical difficulties encountered by those countries that have rushed to adopt IFRS for SMEs. This paper attempts to provide extensive insights on the development and implementation process of IFRS for SMEs around the world. Such analyses and insights will assist in revising IFRS for SMEs and will minimize future complications in the SME convergence process.

Prior studies on the financial reporting transformation process with the convergence of international standards have revealed several functional complications and persistent issues with the full set of IFRS. Lack of expertise in the accounting and auditing professions, and inadequate resources and infrastructure facilities for the implementation of complex, principles-based international standards in developing and transitional economies have been widely articulated (Alp & Ustundag, 2009; UNCTAD, 2007a). In particular, the potential knowledge shortfall and strangeness of IFRS and their adverse impact on the professional judgments of accountants in applying the standards are evident (Alp & Ustundag, 2009; Chand, Patel, & Patel, 2010; Wong, 2004). Both Alp and Ustundag (2009) and Chand et al. (2010) pointed out the need for an international mechanism to enable the effective enforcement of IFRS in individual jurisdictions. Inconsistencies in the regulatory frameworks and deficiencies in the legal support for implementing international standards at national level have posed significant challenges for implementing full IFRS (Alp & Ustundag, 2009). Moreover, Chand et al. (2010) found that country-specific characteristics, such as existing accounting standards at national level prior to the implementation of international standards, and accounting regulatory frameworks themselves, influence the adoption of IFRS across countries.

Generally, prior studies reveal that the implementation of IFRS by individual countries seems to be challenging, in spite of whether the standard is complex or if it is a simplified version. Therefore, more research on the financial reporting transformation experience of and by non-publicly accountable entities and SMEs is timely and essential (Evans et al., 2005). More specifically, the possible transition issues that may arise when moving from local GAAP/full IFRS to IFRS for SMEs have not been addressed in depth so far in the literature (AASB, 2010a; Evans et al., 2005).

Importantly, the IASB’s objective of introducing IFRS for SMEs is centered on a new paradigm of “enhancing decision usefulness” and “reducing information asymmetry” of the financial information provided by the SMEs across the globe. In accordance with this new paradigm, this study applies the framework of decision usefulness theory and the pecking order theory to evaluate issues pertaining to the development and implementation of new IFRS for SMEs. This paper provides evidence that IFRS for SMEs have been a challenge for non-publicly accountable entities to adopt. This study identifies several issues with IFRS for SMEs and their implementation in a variety of countries. The analyses also provide important insights for prospective countries that are planning to adopt IFRS for SMEs in the future.

The remainder of this paper is organized as follows. Section 2.1 reviews the accounting regulatory framework of SMEs. Section 2.2 outlines various definitions that have been used to define SMEs across the globe. Section 2.3 reveals the importance of SMEs. Section 2.4 provides an overview of the contents of IFRS for SMEs. Section 2.5 provides detailed information about the adoption of IFRS for SMEs across the globe. Section 2.6 identifies both the conceptual and technical problems posed by IFRS for SMEs during the initial implementation process of the new set of standards. Section 2.7 concludes with a review of the possible implications of IFRS for SMEs.

2.1 ACCOUNTING REGULATORY FRAMEWORK FOR SMES

It is widely accepted that explicit accounting information leads to the successful management of a business, irrespective of its size—large or small (EC, 2012). Generally, SMEs are exempt from statutory audit requirements and/or are subject to simplified accounting standards (IFC, 2011).[1] With the full set of IFRS applied for publicly accountable entities, several arguments were raised by small entities about the complexity of applying full IFRS. Therefore, the need for a simplified set of accounting standards suitable for SMEs was extensively appealed by many jurisdictions. Consequently, the IASB issued IFRS for SMEs in July 2009 with the intention that they would be applied by SMEs around the globe.

It is recognized that IFRS enhance the comparability of financial information of different entities across the globe (IASB, 2009b). Unlike publicly accountable entities whose securities are traded in public capital markets, SMEs usually do not have the accountability to present high quality comparable financial information for users. However, the IASB is of the view that SMEs would benefit by being able to access competitive loans from multinational financial lenders, if the financial statements between the countries were comparable. The primary objective of introducing this standard is to provide financial reporting relaxation and reduce the administrative burden of entities that do not have public accountability but prepare general purpose financial statements (GPFSs) for external users. The IASB believes that the simple version would reflect the needs of users of SMEs' financial statements and the cost-benefit considerations of SMEs (IASB, 2009b).

The IASB's objective of introducing a new accounting regulatory framework for SMEs embraces the concept of 'user oriented financial information'. The attention on the decision usefulness in IFRS for SMEs is a paradigm shift from the traditional focus of financial reporting of SMEs. The decision usefulness theory assumes that "the basic objective of accounting is to aid the decision-making process of the relevant 'users' of accounting reports by providing useful or relevant accounting data" (Godfrey, Hodgson, Tarca, Hamilton, & Holmes, 2010, p. 24). This theory provides a logical framework from which

[1] The IFC is the leading technical advisor to the G-20 Global Partnership for Financial Institutions' (GPFI) SME Finance sub-group and is a member of the World Bank group, which prepares the SME Finance Policy Guide for the World Bank.

to derive accounting principles and practices. In the history of the financial reporting standard setting process, decision usefulness theory has been an important yardstick in choosing appropriate accounting treatments that fit the information needs of users (Son, Marriott, & Marriot, 2006).

Extant literature points out that little is known about the real users and their information needs in relation to SME financial statements (see Dang-Duc, 2011; Evans et al., 2005; Sian & Roberts, 2008 and Son et al., 2006 for review). Even in the limited available literature, there is an inconsistency in the findings on users and their information needs in relation to SME financial statements and these questions remain unanswered (Son et al., 2006). Users and their information needs are varied between publicly accountable entities and non-publicly accountable entities. The development process of simplifying the accounting principles and practices based on the same conceptual framework and the extent to which these simplifications are derived from the information needs of the users of SMEs financial information is however unclear.

Another revolutionary idea in introducing IFRS for SMEs is to enhance SMEs access to international capital through high quality, harmonized financial statements. As suggested by the pecking order theory, entities prioritize their sources of financing in a hierarchical order of preference from internal sources of financing, debt financing to equity financing (Myers, 1984). According to this theory, the information asymmetry affects the choice between internal and external sources of financing (Myers, 1984). As far as the effective use of financial information in accessing external sources of funds is concerned, the IASB’s objective of reducing information asymmetry of SMEs by preparing high quality financial statements using IFRS for SMEs needs to be evaluated using the pecking order theory.

2.2 DEFINITIONS FOR SMALL AND MEDIUM-SIZED ENTERPRISES

It is generally claimed that there is no universally accepted definition for SMEs. In fact, it is difficult to adopt a universal definition for SMEs due to differences in firm size, sectors, culture and the development status of economies in which SMEs operates (Kushnir, 2010; UNCTAD, 2007b). Gibson and Vaart (2008) propose a new quantitative formula for defining SMEs that takes into account the revenue of a company and the country-specific economic context in which the SME operates.[2] The economic considerations (Gross National Income and Purchasing Power Parity) incorporated into this formula would ensure a consistent approach for defining SMEs in USD terms across countries and would improve the comparability between different SMEs operating in the global market, thereby overcoming the difficulties of adopting a one-size-fits-all approach (Gibson & Vaart, 2008). However, some definitions specific to international organizations (for example, the European Commission, World Bank, and United Nations Development Programme) and country-specific definitions for SMEs remain prominent and are often based on size-thresholds such as employee headcount, annual turnover and total asset values.

The European Commission (EC) adopted the Commission Recommendation 2003/361/EC of 6th May 2003 on the new definition of SME with effect from 1st January 2005 (EC, 2003). The EC is of the view that “it is essential that measures in favour of SMEs are based on a common definition to improve their consistency and effectiveness, and to limit distortions of competition” (EC, 2003, p. 6).

As shown in Table 2.1, EC has three distinct categories of SMEs. In the largest category, medium-sized enterprises consist of enterprises that employ less than 250 employees with an annual turnover of less than or equal to 50 million Euros and an annual balance sheet total of less than or equal to 43 million Euros. Secondly, small enterprises are defined as enterprises which employ less than 50 employees and whose annual turnover or annual balance sheet total does not exceed 10 million Euros. Thirdly, micro-enterprises are defined as enterprises which employ less than 10 employees and whose annual turnover or annual balance sheet total does not exceed 2 million Euros. The employee headcount threshold is compulsory; however it is not mandatory to meet both turnover and balance sheet thresholds concurrently (EC, 2003). This ensures that SMEs engaged in different types of economic activity are treated fairly, given that their financial information is by nature different. In accordance with the definition, an entity needs to be an “enterprise” to qualify as an SME, defined as any entity engaged in an economic activity, irrespective of its legal form (EC, 2003).

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[2] The proposed formula is expressed as *Annual Turnover between USD Minimum 10-Maximum 1000 * Mean Per Capita Gross National Income at Purchasing Power Parity* of the country in which the SME operates.

It is worthwhile to note that the criteria defined in the EC definition are the key conditions for treating an enterprise as an SME. An enterprise will be treated differently depending on whether the enterprise has any relationships, partnerships or links with other enterprises. The EC has affirmed that the use of the definition is voluntary for its member states, though the Commission, together with the European Investment Bank and the European Investment Fund, urges them to apply it as widely as possible (EC, 2003).

The World Bank identifies only the maximum threshold for defining SMEs, with no classification made between *micro*, *small* and *medium* enterprises to reflect the size of the enterprise. As defined by the World Bank, the maximum threshold for the number of employees is 300, with maximum revenue (turnover) and assets value of 15 million US dollars each (Gibson & Vaart, 2008).

There is no common definition for SMEs in Asia Pacific Economic Corporation (APEC) economies (see Table 2.1 for examples). In Australia, for example, the Australian Bureau of Statistics (ABS) defines a micro-enterprise for statistical purposes as an enterprise that has less than 4 employees. A small enterprise is defined as an actively trading business that has less than 19 employees, and a medium enterprise as an actively trading business that has between 20 to 199 employees (DIISR, 2011).[3] Australian SME financial reporting is based on the *Reporting Entity Concept* as defined by the Statement of Accounting Concepts (SAC 1) (Public Sector Accounting Standards Board, 1990).[4]

In Canada, the Public Works and Government Services of Canada (PWGSC) defines SMEs as enterprises whose employee count is less than 500. The threshold for *small manufacturing enterprises* is less than 100 employees and for *service enterprises* are less than 50 employees (PWGSC, 2011). In Korea, the Small Business Corporation (SBC) of Korea defines SMEs as enterprises that have less than 300 employees with a capital worth of $8 million or less for *manufacturing enterprises.* They categorize micro and small manufacturing enterprises as those that employ 10 and 50 employees respectively (SBC,

[3] Actively Trading Businesses are businesses that have an Australian Business Number (ABN).

[4] A Reporting Entity is defined as follows: "an entity in respect of which it is reasonable to expect the existence of users who rely on the entity's general purpose financial statements for information that will be useful to them for making and evaluating decisions about the allocation of resources. A reporting entity can be a single entity or a group comprising of a parent and all of its subsidiaries." (AASB, 2011, p. 10)

2009). Singapore adopted a new definition for SMEs with effect from 1st April 2011, whereby an SME is defined as a company whose annual sales turnover is not more than S$100 million or who employs not more than 200 workers (The Standards, Productivity & Innovation Board Singapore, 2011). In Japan, the Ministry of Economy, Trade and Industry (METI) defines SMEs in four industry categories; *manufacturing, wholesale, retail and services*, and a Japanese SME is defined as an enterprise which employees 300 or less people and whose capital size is ¥ 300 million or less (EIU, 2010).

The Asian Development Bank (ADB) has not introduced a formal definition for SMEs; however, ADB relies on a country-specific definition in its place. There is no common definition for SMEs among South Asian countries; instead, different countries adopt different definitions for SMEs decided by their own parameters (see Table 2.1 for South Asian Country-Specific SME definitions).

The United States of America (US) takes a different approach to defining SMEs. The Small Business Administration (SBA) has established "size standards" for small businesses (SBA, 2012).[5] A size standard is stated in the number of employees or average annual receipts, and is set for each individual North American Industry Classification System (NAICS) coded industry.[6] Based on these criteria, SBA has established a standard of 500 employees for most manufacturing and mining industries and US$7 million in average annual receipts for most non-manufacturing industries (SBA, 2012).[7] The US definition for small businesses seems complex in nature, but variations in size standards are assumed to depict industry differences better than any other definitions discussed so far.

The IASB adopted a definition for SMEs when IFRS for SMEs came into effect in July 2009. According to the standard, SMEs are entities that:

a) do not have public accountability, and

[5] The SBA is a US government agency that provides a wide range of financial and counseling support to entrepreneurs and small businesses.

[6] NAICS is the standard used by Federal statistical agencies to classify business establishments for the purpose of collecting, analyzing and publishing statistical data related to the US business economy.

[7] See http://www.sba.gov/content/summary-size-standards-industry for a summary of size standards by industry.

> b) publish general purpose financial statements for external users. Examples of external users include owners who are not involved in managing the business, existing and potential creditors, and credit rating agencies (IASB, 2009a, p. 10).

An entity has public accountability if:

> a) 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 (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets); or
> b) it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. This is typically the case for banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks (IASB, 2009a, p. 10).[8]

The IASB's definition of SMEs is more loosely defined than the typical SME definitions adopted by various jurisdictions. The RSM International Association indicates that:

> This definition avoids a quantified size test and, instead, adopts a public accountability principle. IFRS for SMEs has been designed using a 50-employee typical entity guideline, not as a quantified size test for defining SMEs but rather to assist the Board in determining the types of transactions that the standard should address… (RSM International Association, 2009, p. 5).

Revelations of the various SME definitions illustrate that there is inconsistency in the definitions of SMEs across the globe. In particular, the definition of an SME in the context of IFRS for SMEs is significantly different to that of most other countries and is based on the listed status of an entity rather than on its size-threshold. Authorities at the individual jurisdiction level are permitted to decide what constitutes an eligible entity and are entitled to apply IFRS for SMEs (IASB, 2009a). However, the inconsistency between general

[8] The IASB has made limited amendments to IFRS for SMEs after completing the initial comprehensive review in May 2015 (IFRS Foundation, 2015a). The definition in paragraph 1.3 (b) has been rephrased as "it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses. Most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet this second criterion" (IFRS Foundation, 2015a, p. 19).

definitions of an SME and IASB's definition is problematic in terms of the implementation of IFRS for SMEs, as will be explained in Section 2.6.

2.3 IMPORTANCE OF SMES ACROSS THE GLOBE

SMEs play a vital role in economic and social development in developed and developing economies. In many APEC economies, SMEs hold a major share of businesses and employment and contribute significantly to economic output (APEC, 2009). For example, in Australia, SMEs accounted for 99.7 percent of actively trading businesses in June 2009 (DIISR, 2011). Importantly, the majority of Australian SMEs function as the resource providers for large manufacturing firms. In terms of employment, SMEs accounted for 70.5 percent of total industry employment in 2009-2010 (DIISR, 2011).

In other countries and regions, the contributions made by SMEs are also significant. For example, SMEs in China play a significant role in economic development, accounting for a GDP contribution of 60 percent in 2009. Chinese SMEs created around 80 percent of urban job opportunities in 2009 (Zhu, Wittmann, & Peng, 2012). More importantly, the role of SMEs in the field of technology innovation is regarded as remarkable. Since economic reform, more than 65 percent of invention patents, 75 percent of technological innovation, and 80 percent of new product development have been recorded by Chinese SMEs (APEC, 2008). In Japan, almost 99 percent of businesses are considered to be SMEs, representing the majority of the employed population and accounting for a significant proportion of the economic output (EIU, 2010).

The economic and social contribution of SMEs in a number of developing countries has also received increased attention. SMEs in Sri Lanka provide a growing contribution to the GDP (52 percent in 2011), particularly in agriculture, plantation, construction, manufacturing and trade sectors (Department of Development Finance, 2011). The SME Chamber of India (2012) reports that around 45 percent of industrial output, 40 percent of exports and 42 million people in employment are contributed by SMEs. In South Africa, SMEs, which account for around 91 percent of formal business entities, had contributed around 57 percent and 60 percent to the GDP and employment respectively by the end of 2009 (Kongolo, 2010).

In Europe, SMEs accounted for a 67 percent share of the total employment in 2010 (EIM Business and Policy Research, 2011).[9] In the period 2002-2010, SMEs created 85 percent of net new jobs in the EU, of which micro-firms (by definition having fewer than 10 employees) accounted for the highest percentage of 58 percent (EIM Business and Policy Research, 2011). This figure also indicates a significant growth of micro-firms in the EU during the last few years.

The United States Trade Representative (USTR) (2010) reports that SMEs in manufacturing and services sectors have entered into 'direct exports', by contrast with large multinational firms, which trade mostly through foreign affiliates. During the period 2005-2009, 73 percent of foreign sales were committed by their exporting SMEs through direct exports. Importantly, these direct exports have led to the creation of nearly 2 million jobs (USTR, 2010).

The above facts confirm that the SME sector has been positioned as the most crucial sector and the backbone of many developed and developing economies around the world. Therefore, the accounting information presented by these focal entities is equally important. It is envisaged that the global convergence of the financial reporting practices of SMEs will possibly open access to international finance through high quality, comparable financial information (IASB, 2009a).

2.4 IFRS FOR SMES AT A GLANCE

IFRS for SMEs are a simplified version of full IFRS which is primarily based on the fundamental principles of full IFRS (IASB, 2009b). However, IFRS for SMEs is a stand-alone document—logically structured into 35 sections by topic. IFRS for SMEs approaches with significantly reduced disclosures of around 300, compared to full IFRS of 3000 disclosures, and with reduced guidance. The standard is based on simplified recognition and measurement principles and several easy accounting policies. Several topics have been omitted from IFRS for SMEs which are not relevant to SMEs (e.g. earnings per share, interim financial reporting, segment reporting, and special accounting for assets held for

[9] A study on the impact of SMEs on the EU labor market was conducted by EIM Research & Business Policy-Netherlands on behalf of the EC in 2011.

sale), and extra considerations specific to SMEs (e.g. combined financial statements, original issue of shares or other equity instruments, sale of options, rights and warrants, and capitalization or bonus issue of shares and share splits) have been incorporated (IASB, 2009b).

The main simplification of recognition and measurement principles of IFRS for SMEs compared to full IFRS are contrasted in several sections of IFRS for SMEs (the key differences between IFRS for SMEs and full IFRS are shown in Table 2.2).[10] The accounting treatment under Section 19 *Business Combinations and Goodwill* in IFRS for SMEs is significantly different to IFRS 3 *Business Combinations.* Under IFRS 3, goodwill and other intangible assets with a definite useful life are reviewed for impairment and not amortized. In contrast, goodwill and intangible assets are amortized over their useful life in IFRS for SMEs. If a reliable estimate of the useful life cannot be made, "life" is presumed to be 10 years (Ernst & Young, 2010; IASB, 2009a).[11]

Section 14 *Investments in Associates* and Section 15 *Investments in Joint Ventures* of IFRS for SMEs, permit investments in associates and jointly controlled entities to be accounted for, using the cost model (if a published price quotation is not available), the equity method and the fair value model. In contrast, International Accounting Standard (IAS) 28 *Investments in Associates & Joint Ventures* permits the equity method to be used in the consolidated accounts (Ernst & Young, 2010; IASB, 2009a).

Recognition and measurement of "uncertain tax positions" have been incorporated into IFRS for SMEs (Sections 29 *Income Tax)* and deferred tax assets have to be recorded under IFRS for SMEs with offsetting valuations allowances, which is not covered by IFRS (IAS 12 *Income Tax*) (Ernst & Young, 2010; IASB, 2009a).[12]

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[10] The simplification in the recognition and measurement requirements of IFRS for SMEs discussed in this paper are based on the first publication of IFRS for SMEs issued in 2009. The analysis also refers to the amendments made in May 2015, which will be effective from the annual periods beginning on or after 1 January 2017.

[11] The amendments to IFRS for SMEs require that if a reliable estimate of useful life cannot be made, management must use their best estimate which shall not exceed 10 years (IFRS Foundation, 2015a).

[12] The IASB has amended Section 29 *Income Tax* of IFRS for SMEs by aligning the main recognition and measurement requirements for income tax with IAS 12 *Income Taxes* of full IFRS which will be effective on or after 1 January 2017 (IFRS Foundation, 2015a).

2.5 ADOPTION OF IFRS FOR SMES ACROSS THE WORLD

It is now nearly six years since IFRS for SMEs was first issued. The recent statistics show that nearly 70 jurisdictions have either adopted IFRS for SMEs or made a public announcement of their intention to apply the standard in the future (IFRS Foundation, 2014a). Some countries in South America, Central America, the Caribbean, Africa, Asia, Middle East and European regions have adopted IFRS for SMEs (see Table 2.3) (IFRS Foundation, 2014a).

South Africa was an early respondent to IFRS for SMEs, having adopted the standard with no modifications when the ED of IFRS for SMEs was issued by the IASB in October 2007 (IFRS Foundation, 2012a). However, the South African Institute of Chartered Accountants (SAICA) had been working on developing a third tier financial reporting framework for micro-entities (Micro GAAP) as they believed that the ED of IFRS for SMEs was burdensome for micro-entities (SAICA, 2012). Later, SAICA withdrew the proposed Micro GAAP as IFRS for SMEs was issued in 2009 in a more simplified version than the ED. Nevertheless, the SAICA has developed a separate electronic guide for micro-entities on applying IFRS for SMEs, comprising of more practical examples, illustrative financial statements and user and disclosure checklists (SAICA, 2012).

Hong Kong, on the other hand, has also adopted IFRS for SMEs, but with a few modifications made to the standard—referring to them as the Hong Kong Financial Reporting Standards (HKFRS) for Private Entities. Their standard is primarily based on IFRS for SMEs, but refers to “Private Entities” rather than “SMEs”. However, the same definition as applied by the IASB to define eligible entities for IFRS for SMEs has been adopted. The standard setters believe that the national criteria used to define SMEs often refer to smaller entities irrespective of whether they prepare GPFSs for external users. Therefore, based on this argument, the Hong Kong Institute of Certified Public Accountants (HKICPA) has replaced the term “SMEs” with “Private Entities”. All other smaller entities which do not come under the “Private Entities” definition are therefore eligible to apply the locally developed SME Financial Reporting Framework and Financial Reporting Standard (SME-FRF & FRS). Furthermore, HKFRS for Private Entities has replaced certain income tax recognition and measurement principles in Section 29 of IFRS for SMEs with certain tax requirements in the extant version of HKAS (Hong Kong

Accounting Standards) 12 *Income Tax*. These changes ensure the appropriateness of HKFRS for Private Entities, and ease the changeover from the existing HKFRS to HKFRS for Private Entities (HKICPA, 2011, 2012).

For SMEs in Brazil, the Brazilian Accounting Pronouncement Committee has introduced CPCs for SMEs (new Brazilian GAAP for SMEs) which is a translation (Portuguese version) of IFRS for SMEs. However, in addition to the IASB definition for SMEs (non-publicly accountable entities), a Brazilian SME also needs to meet certain "size criteria" to qualify for the application of the standard (PriceWaterhouseCoopers, 2012).[13] Brazil has also made a few modifications to IFRS for SMEs by requiring SMEs to use the equity method to account for investments in subsidiaries in separate financial statements (IFRS Foundation, 2014a).

Countries such as Argentina, Bahamas and Cambodia have also adopted IFRS for SMEs as published by the IASB with no amendments made to the standard. These countries have kept the use of the standard optional whereby SMEs may use the national GAAP or alternatively full IFRS, according to their requirements (see Figure 2.1 for the application status of IFRS for SMEs).

It is important to note that major developed and developing countries such as Australia, the United Kingdom, France, Germany and Canada have still not adopted IFRS for SMEs. There are several reasons for a number of prominent countries choosing not to adopt IFRS for SMEs, which are revealed in Section 2.6.

2.6 PROBLEMS POSED BY IFRS FOR SMES

The discussions on issues in the financial reporting convergence process have been motivated since the inception of the implementation process of the full set of IFRS. There have been several functional complications reported in the convergence process of IFRS by countries that have adopted IFRS (Alp & Ustundag, 2009; UNCTAD, 2007a; Wong, 2004). Conversely, due to the recent publication of IFRS for SMEs and the slow take-up of the new standard by various jurisdictions across the globe, the consequences of adopting

[13] Size criteria include: Revenue < R$300 million and Total assets < R$240 million.

IFRS for SMEs are still presumed to be impending. Diverse complications and controversial issues in adopting IFRS for SMEs have been reported by many jurisdictions, especially by developed countries. Taking examples from the implementation of the full set of IFRS and IFRS for SMEs context, the next section provides a holistic view on the problems experienced and the possible challenges in implementing IFRS for SMEs across the globe. To evaluate the problems posed by the implementation of IFRS for SMEs, this discussion applies, where relevant, decision usefulness theory and pecking order theory.

2.6.1 Issues with the IASB's development process of IFRS for SMEs

The IASB has set meeting the needs of users of SME financial statements as one of the primary objectives of introducing IFRS for SMEs. The IASB (2009b) points out that the differences between full IFRS and IFRS for SMEs should be established based on the accounting information needs of the users and cost-benefit considerations. Such views show that the accounting information needs of the users have been an important benchmark in the differential reporting framework introduced by the IASB.

As explained by the decision usefulness theory, assessing the decision usefulness of the users is a primary test for defining the generally acceptable principles of accounting regulations. However, Schiebel (2008) demonstrates that IASB has given less consideration to users' participation in the consultation process during the development of the new standard because the major commentators were represented by auditors, accountants and standard setters.[14] Additionally, the European Union consultation on IFRS for SMEs by German Cooperative and Raiffeisen Confederation (DGRV) (2010) reports that no IASB Board member has an SME background or has participated in an SME working group. Therefore, it is unlikely that the concerns of SMEs are adequately addressed in the standard setting process of IFRS for SMEs. If IFRS for SMEs do not reflect the information needs of external users, the perceived benefits of the published information of SMEs for external users become uncertain. In particular, this situation would be more distressing for small and micro-entities.

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[14] The IASB engaged in a long consultation process before releasing IFRS for SMEs in July 2009. They published a discussion paper for public comment in June 2004 to gather preliminary views on the new standard.

The IASB's objective of allowing SMEs to access international competitive funds by producing high quality, comparable financial statements is a remote objective. This objective coincides with the pecking order theory, which explains that an entity's choice of finance between internal and external sources varies with the level of information asymmetry of financial information. Regardless of reducing the information asymmetry, SMEs in general are hesitant to seek external sources of capital because of several external constraints such as the complex procedures involved in granting loans, collateral requirements and the associated high capital cost (Hyz, 2011). Rather, the majority of SMEs still rely on owner financial resources and retained earnings as suggested by the pecking order theory. Kauffmann (2005) confirms that there is limited access to formal finance sources as a result of the high default risk among SMEs in Africa. Furthermore, the development stage of the entity, creditworthiness, liquidity position and delinquency of SMEs are also found to be barriers to accessing external funds. Therefore, the preparation of high quality financial statements may not be the exclusive solution for accessing external funds, particularly accessing international funds.

A narrow definition of non-publicly accountable entities has made it confusing for eligible entities to apply the eventual standard. As previously outlined, the IASB (2009a) defines an SME as an entity that does not have public accountability but prepares general purpose financial statements for external users. However, there appears to be an inconsistency in this definition between the criterion used to define an SME – "non-publicly accountable entities" and the intended users of the standard – "SMEs". Whilst conveying the importance of introducing IFRS for SMEs, the IASB stresses that SMEs are estimated to represent more than 95 percent of all companies around the world (IFRS Foundation, 2012a). However, this estimation is based on those SMEs that were categorized according to size-thresholds, not necessarily based on the criterion of non-publicly accountable entities envisaged by the IASB.

The history of the development of the project and implementing IFRS for SMEs provides evidence that the IASB has been confused in selecting an appropriate title, with changes made to the title several times. The title "IFRS for SMEs" was finally agreed a few months before the release of the standard in July 2009 (RSM International Association, 2009).[15] This may pose issues in implementing the standard due to the inconsistency between the IASB definition of SMEs and the various definitions adopted by other countries and regions to define SMEs.

It is worth mentioning that the majority of SME definitions include “micro” enterprises, though the abbreviation “SME” refers only to small and medium enterprises. For this reason, the abbreviation “MSME” (micro, small and medium-sized enterprises) is becoming popular in place of “SME” for definitions adopted by different economies. For example, South Asian economies such as India, Bhutan, and Maldives are currently using the abbreviation MSME. However, there appears to be an injustice in discussing these three categories of enterprises together, because micro-enterprises and SMEs are distinctly dissimilar in their business scope. The question may again be posed as to whether micro-firms should be treated as SMEs according to the definition adopted by IASB for defining small and medium entities in IFRS for SMEs. Certainly, differently defined SMEs would be a challenge when making comparisons of businesses across the globe.

2.6.2 National legislations and enforcement issues

One of the major issues that need to be discussed during the implementation process of IFRS is the extent to which the fragmented regulatory authorities at the individual jurisdiction level hinder the effective and efficient implementation of international standards (Alp & Ustundag, 2009; UNCTAD, 2007a). Using examples from countries such as Pakistan, South Africa and Turkey to demonstrate, UNCTAD expounds this divergence issue by saying “the practical implementation issue that arises in this context is the extent to which IFRS-based general-purpose financial statements could be used for prudential regulation. Such an arrangement would require clear understanding to be reached among the different regulators” (UNCTAD, 2007a, p. 10).

[15] Other names suggested: IFRS for Private Entities, IFRS for Non-publicly Accountable Entities, IFRS for Nonpublic-Interest Entities, IFRS for Private Companies, IFRS for Smaller Entities, IFRS for Unlisted Entities, and IFRS for Limited Interest Entities.

A number of countries have been pressured to establish new institutions or to reinforce the roles of existing institutions to strengthen the enforcement conduct of the regulatory authorities (UNCTAD, 2007a). Moreover, Alp and Ustundag (2009) and UNCTAD (2007a) point out that the successful enforcement of international standards at each country level will be challenging in the absence of consistency in the regulatory framework and the legal backing of IFRS. Within this context, the implementation of IFRS for SMEs would be confronted with national legislation requirements. In many countries, SMEs are required to prepare financial statements in compliance with certain tax legislation, especially for the purpose of filing tax returns. Countries such as Lebanon, Slovakia, Austria, and Russia believe that SMEs are in favor of preparing financial statements for tax purposes only (IFRS Foundation, 2011). Therefore, IFRS for SMEs is believed to be a burden and too difficult for their SMEs to adopt. For example, in Germany, financial statements usually serve a multi-purpose function and therefore, SMEs prefer to prepare a single set of financial statements which also satisfies taxation purposes (Evans et al., 2005). France, on the other hand, rejected IFRS for SMEs as they do not adequately fit with their integrated tax and accounting framework (PWC, 2010). Evans et al. (2005) also points out that the preparation of separate financial and tax accounts would be costly and a burden for small entities.

There are several incidences in which the issue of adopting IFRS for SMEs arises due to inconsistencies in reporting frameworks determined by individual jurisdictions (locally developed GAAPs) and IFRS for SMEs. Countries such as Japan, Austria, Germany, Belgium, Indonesia, India and several other jurisdictions emphasize their requirement for compliance with national laws and other local GAAPs for SMEs, rather than adopting IFRS for SMEs (IFRS Foundation, 2011). There are also countries that do not apply GAAP at present for their SMEs. The United Arab Emirates (UAE), for instance, currently does not have national GAAP for SMEs in its reporting framework and is therefore uncertain about adopting IFRS for SMEs for all the business entities due to its immaturity in applying a financial reporting framework and due to potential knowledge shortfall (ICAEW, 2010). The UAE economy is substantially represented by family-owned businesses. These family businesses have generally not opted for the use of IFRS for SMEs (IFRS Foundation, 2014a). Japan, on the other hand, has still not formally adopted full IFRS in their reporting framework and therefore is not considering adopting IFRS for SMEs at this stage (IFRS Foundation, 2011).

2.6.3 Complexity and other difficulties in implementing IFRS for SMEs

The issue of the complexity of the international standards has been persistently discussed since the inception of IFRS implementation process. A number of studies have identified that the complex nature of the full set of IFRS poses several practical difficulties, particularly in developing economies (Alp & Ustundag, 2009; UNCTAD, 2007a; Wong, 2004). Moreover, a lack of technical expertise in the accounting and auditing professions and the potential knowledge shortfall in dealing with international standards has been widely articulated (Alp & Ustundag, 2009; UNCTAD, 2007a). IFRS for SMEs are deemed to be a less complex and simplified version of the full set of IFRS, but as far as the intended users of the new standard are concerned, several arguments have been made about the incongruity and the burden of IFRS for SMEs. For example, having experienced several difficulties in adopting full IFRS in 2005, Australia is more concerned about the possible transition issues that may arise during the implementation process of IFRS for SMEs (AASB, 2010a). The transition process from local GAAP/full IFRS to IFRS for SMEs may impose certain difficulties on business practices, processes and systems, which often turn out to be costly, complex and prolonged for small entities to take on.

Australia is of the view that IFRS for SMEs still appear to be complex in the recognition and measurement requirements (AASB, 2010a). Deloitte Touche Tohmatsu (Australia) reports that:

> The approach of effectively adopting IFRS for all entities in Australia from 2005, albeit with an overlaid ‘reporting entity’ concept, has meant that a lot of the ‘pain’ of adopting IFRS has already been incurred in the Australian context. Compared with IFRS, *IFRS for SMEs* do not result in a substantial reduction in complexity in the recognition and measurement requirements - and in fact many ‘simplifications’ may be more onerous in practice (e.g. introduction of ‘uncertain tax position’ accounting for income taxes), be counterintuitive (e.g. mandatory amortization of goodwill over a 10 year period) or may ultimately be adopted in ‘IFRS proper’ (e.g. rewrite of financial instruments requirements). Furthermore, there are as yet no widely accepted interpretations of contentious issues under *IFRS for SMEs*, a position similar to the original IFRS transition in 2005, with all the uncertainty this brought on transition (AASB, 2010a, p. 1).

Difficulties in implementing an international standard because of a lack of widespread technical expertise in the accounting environment are also a concern. Australia is also of the view that the coexistence of opposing IFRS recognition and measurement principles for identical circumstances harms the standards and also the practitioners. For these reasons, Australia has so far not adopted IFRS for SMEs. Instead, the AASB has adopted the Reduced Disclosure Regime (RDR) implemented under the revised differential reporting framework for issuing new accounting standards—*AASB 1053 Application of Tiers of Australian Accounting Standards* and *AASB 2010-2 Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements* in 2010. This has made amendments to the existing Australian Accounting Standards, including the Interpretations. The publicly accountable entities are required to apply full IFRS as adopted in Australia under Tier 1, whereas all other preparers of GPFSs which fall into Tier 2, are required to apply IFRS recognition, measurement and presentation requirements with substantially reduced disclosures (AASB, 2010b).[16]

Similarly, the European Commission has kept the adoption of IFRS for SMEs within the European Union optional. There appears to be no strong objection to adopting the new standard; however, the EC is of the view that the objectives of simplification and reduction of administrative burden would not be served by IFRS for SMEs (EC Explanatory Memorandum, 2011). The European Financial Reporting Advisory Group (EFRAG) reports that IFRS for SMEs' conventions are incompatible with EU Directives (Fourth & Seventh) in several ways (EFRAG, 2010).[17] This will result in financial statements prepared under IFRS for SMEs being neither comparable with financial statements prepared according to EU Accounting Directives nor with full IFRS financial statements (DGRV, 2010). In addition to the issues mentioned above, complexities arising with future changes to full IFRS and additional difficulties encountered by subsidiaries and companies planning to transition to full IFRS are major concerns in Europe in relation to not adopting IFRS for SMEs.

For these reasons, after certain review processes for the adoption of IFRS for SMEs and EU Accounting Directives, the European Commission published a Proposed Directive on

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[16] See http://www.aasb.gov.au/Pronouncements/RDR-early-application-versions-2011-2012.aspx for 2011/12 RDR versions.

[17] EFRAG carried out this compatibility study on behalf of the European Commission in 2010.

25th October 2011 which is a specific regime for small companies and replaces the Fourth (78/660/EEC) and Seventh (83/349/EEC) Company Law Directives (*Treaty on the annual accounts of certain types of companies* and *Treaty on consolidated accounts* respectively) (EC Explanatory Memorandum, 2011). The aims of this Proposed Directive are to reduce the administrative burden on small companies and increase the comparability of the financial statements. The main simplification effects are outlined in Table 2.4.

The principal modification to the existing provisions is the introduction of general principles of "materiality" and "substance over form" to increase the clarity of the financial statements (EC Explanatory Memorandum, 2011).

Canada has also opted for developing an independent set of standards for their private entities rather than choosing IFRS for SMEs. KPMG (2009, p. 2) states that "some requirements of IFRS for SMEs, such as consolidation; componentization of property, plant and equipment; and deferred income tax accounting do not recognize the needs of and are inappropriate for Canada's private businesses and the users of their financial statements." Followed by a "made-in-Canada" approach, the Canadian Accounting Standards Board has published a simplified set of accounting standards for private enterprises which is called "Accounting Standards for Private Enterprises (ASPE)" in 2009.

2.6.4 Technical difficulties inherent in IFRS for SMEs

With respect to the technical matters that persist with the implementation of the full set of IFRS, the UNCTAD argues that "the practical implementation of IFRS requires adequate technical capacity among preparers, auditors, users and regulatory authorities. Countries that implement IFRS face a variety of capacity-related issues; depending on the approach they take" (UNCTAD, 2007a, p. 11).

The practical implementation of IFRS for SMEs would also be challenging, because the capacity limitations of financial markets, institutions and regulatory authorities vary across the globe. Prominent professional accounting networks such as PWC (2011), Ernst &

Young (2010) and KPMG (2010) demonstrate the possible problematic sections of IFRS for SMEs that could develop with so-called capacity limitation issues.

As specified by Section 26 *Share Based Payments* of IFRS for SMEs, if the fair value of shares in equity-settled share-based payments is not observable, and obtaining entity specific market data is impracticable, the directors should use their judgment to apply the most appropriate valuation methodology (see Table 2.2). Since full IFRS (IFRS 2 *Share Based Payments*) allows using "Intrinsic Value" in the absence of a reliable estimate of fair value, the IASB believes that the simplified valuation of share-based payments would be appropriate for SMEs. However, PWC (2011) points out that only in rare situations is it unable to estimate the reliable fair value. Furthermore, the Institute of Chartered Accountants Australia (ICAA) (2012, p. 3) points out that "an intrinsic value model would require a valuation to be conducted on the SME's shares in any event. It is difficult to see any simplifications here". Therefore, ICAA (2012) suggests that it is necessary to specify valuation models for SMEs to determine the fair value. The technical challenges in fair value-based measurement requirements in IFRS have, however, been a major issue of concern. More specifically, differences in the liquidity of capital markets and the lack of availability of recent capital market information of different economies would be challenging issues, for which practitioners need to seek alternative sources of measurement. The accurate estimation and consistent application of these alternative measurements would nevertheless be a confronting issue (Alp & Ustundag, 2009; Mala & Chand, 2012; UNCTAD, 2007a).

Accounting for *Borrowing Costs* (Section 25) of IFRS for SMEs is another area where technical implementation difficulties may occur. Section 25 allows an SME to expense all borrowing costs to profit or loss in the period in which they are incurred. However, Ernst & Young (2010) points out that this recognition may be a significant burden for certain industries, such as 'construction', because it would affect the profit or loss with a considerable cost being charged to income statement.

Deferred tax assets (Section 29), which have to be recorded with offsetting valuation allowances, and recognition and measurement under "uncertain tax positions", have been incorporated into IFRS for SMEs. ICAA (2012) and Ernst & Young (2010) believe that these two requirements will be difficult for small entities to apply in practice and that their incomprehensible nature will lead to interpretation issues for the preparers of financial statements.[18] Similarly, the insufficiency of available guidance on the foreign currency translation (Section 30), which may result in different interpretations being adopted by different entities, is also a concern (Ernst & Young, 2010).

Section 17 of IFRS for SMEs has prohibited the revaluation option of accounting for Property, Plant and Equipment (PPE) believing that the revaluation of PPE is one of the complex accounting policy options in full IFRS. Considering this as a significant barrier to the adoption of IFRS for SMEs in jurisdictions where SMEs commonly revalue their PPEs, many accounting regulatory bodies around the world have made representations to the IASB to reconsider incorporating the revaluation option in IFRS for SMEs. Revaluation of PPE has been a common practice among unlisted companies in many countries, particularly where there has been a history of inflation (ACCA, 2012). Many jurisdictions are of the view that the revaluation option does not add significant complexity; rather the fair value measurement in PPE would enhance the relevance and reliability of financial statements for users of SMEs. It would also facilitate access to capital, as in many cases the carrying value of PPE can be a significant portion of an entity's assets (Chartered Accountants of Sri Lanka, 2014; EFRAG, 2014). Hence, the inclusion of revaluation option would offer an opportunity for different jurisdictions to select a measurement option which suits their circumstances (EFRAG, 2014). The EFRAG (2014) also signifies that the negative effects of the application of complex accounting policy options could be outweighed by the increased usefulness of the financial information provided by SMEs.[19]

ACCA (2010) and KPMG (2010) have raised concerns about issues arising from the effect of changes in recognition and measurement principles of IFRS for SMEs on tax and the distributable profits of SMEs. KPMG (2010) points out that changes in the amount of taxes payable (which is either affected by changes in net profit or tax law based on the accounting treatment), the ability to pay dividends; and management compensation (which is based on either net profit or other financial metrics) are the possible impacts of changes in

[18] As the IASB has amended the Section 29 *Income Tax* of IFRS for SMEs by aligning the main recognition and measurement requirements for deferred income tax with IAS 12 *Income Taxes*, it can be expected that these issues will be minimised when the amendments come into effect from January 2017.

[19] After an in-depth consultation with constituents, the IASB has decided to include the option to use the revaluation model for PPEs with effect from 1 January 2017. As such, it can be assumed that these amendments will alleviate these complications and SMEs will reap the aforesaid benefits.

recognition and measurement principles of IFRS for SMEs. Therefore, KPMG (2010) urges the need for sufficient forward planning to control the adverse impacts of adopting IFRS for SMEs.

Furthermore, when developing IFRS for SMEs, some key concepts and application guidance have been dropped in certain sections of IFRS for SMEs. For example, under the section on intangible assets acquired in a business combination, there is an absence of guidance on the types of intangibles that might be recognized, as well as no detail on fair value measurement considerations. Further, the recognition requirements of financial guarantees are not mentioned (ICAA, 2012). Nevertheless, even within the framework of principles-based standards, the reduced guidance of IFRS for SMEs may pose certain difficulties when accountants exercise their professional judgment.

It is argued that the absence of specific guidance on a particular accounting issue leads the users of the standards (specifically the accountants) to a tiered hierarchy to allow the selection of an appropriate accounting policy. This hierarchy flows from the SME's own accounting framework (IFRS for SMEs) of pervasive concepts, to the application of judgment in consultation with the full set of IFRS (ICAA, 2012). For an example, the IFRS Foundation (2012b, p. 1) reports that:

> In the absence of specific requirements for transactions, events or conditions, paragraph 10.4 of IFRS for SMEs requires management to use its judgment in developing an accounting policy that is reliable and results in information that is relevant to the economic decision-making needs of users. Paragraph 10.5 establishes the following hierarchy for an entity to follow in deciding on the appropriate accounting policy:
>
> a) the requirements and guidance in IFRS for SMEs dealing with similar and related issues; and
>
> b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 *Concepts and Pervasive Principles*.

Paragraph 10.6 notes that in making the judgment described in paragraph 10.4, management may also consider the requirements and guidance in full IFRSs dealing with similar and related issues. When following paragraphs 10.4 and 10.5, full IFRS principles may be used in the absence of specific guidance in IFRS for SMEs. Since paragraph 10.4 and Section 2 are based on full IFRSs, using requirements in full IFRSs will result in an appropriate accounting treatment.

The Hong Kong Institute of Certified Public Accountants (2011, p. 3) also points out that:

> If full IFRS is to be used as a fallback, it should first of all not conflict with the requirements and guidance in IFRS for SMEs dealing with similar and related issues and secondly it should not conflict with the pervasive principles in Section 2 of IFRS for SMEs.

Moreover, they are concerned that circumstances may arise, or already exist, where new IFRSs are issued and these new IFRSs are based on principles other than the older IFRS standards on which IFRS for SMEs is based. The specific guidance in the new IFRS could then be applied even when it is inconsistent with guidance provided in IFRS for SMEs on related issues. Furthermore, the Singapore Accounting Standards Council (ASC) (2011, p. 2) points out that:

> As requirements and guidance in full IFRS may not always be consistent with those in IFRS for SMEs, applying full IFRS guidance could result in non-compliance with paragraph 10.5(a), and hence the standard itself. Application of this hierarchy is also problematic in countries who adopt IFRS for SMEs for their non-publicly accountable entities without converging with full IFRS.

In addition to the technical difficulties discussed above, criticisms have been made against differential reporting for SMEs that could lead to different “true and fair views”. Evans et al. (2005) argue that the “true and fair view” principle would not be consistent between entities in the same jurisdiction if different entities are subject to different reporting requirements as specified by full IFRS and IFRS for SMEs. Moreover, the Association of Chartered Certified Accountants (ACCA) (2010) points out that the “true and fair view” becomes subjective when a fair presentation is viewed against differential reporting regimes rather than a single reporting framework common to all entities. Therefore, a number of researchers have suggested giving consideration to reduced or different disclosure requirements for SMEs (compared to full IFRS), rather than different recognition and measurement principles which could lead to different "true and fair views" (Evans et al., 2005).

As evidenced by developed economies such as Australia, New Zealand and the United Kingdom, the major reason for the reluctance to adopt IFRS for SMEs has been the negative perception towards the "two different true and fair views". For example, Australia is of a strong view that "the development of two separate and unrelated suites of accounting principles operating in one economic environment is undesirable" (ICAA, 2014, p. 2). Australian regulators also assert that the IASB's overemphasis on the simplification of accounting principles would lead to divergence in reporting needs between non-publicly and publicly accountable entities. They further stress the existence of inconsistency in the "true and fair view" principle among entities in the same jurisdiction if different reporting requirements as specified by full IFRS and IFRS for SMEs are applied.

The self-contained nature and the stable platform for IFRS for SMEs prevent SMEs departing from the standard and choosing accounting policies from full IFRS (ICAA, 2014; Kemp, 2010). The ICAA and prominent accounting regulatory bodies in Australia have raised concerns that the rapid major changes which have taken place in full IFRS would have to be appropriately embedded into IFRS for SMEs in order to minimize the divergence between IFRS for SMEs and full IFRS. Australia is not in favour of the IASB's decision on IFRS for SMEs to maintain a stable platform without opting for regular updates with recurring changes in full IFRS. This complexity has been articulated by the ICAA and AASB in all their correspondence with the IASB. This has been further articulated in their response to the IASB's recent Request for Information on the ED for SMEs and they emphasize that the IASB needs to reconsider its decisions regarding the simplification of accounting principles in order to make IFRS for SMEs more reasonable and appealing to users (see AASB, 2014; ICAA, 2014 for a review).

The recent comment letter sent by the ICAA to the IASB on ED for IFRS for SMEs acknowledges that:

> One possible consequence of an IFRS for SMEs standard diverging in this way is that the reporting needs of many non-publicly accountable entities will not be

> effectively addressed. The decisions of different jurisdictions worldwide on the adoption of IFRS for SMEs may already be evidence of that. Jurisdictions such as Australia and the UK have used some of its principles in developing local standards for use by non-publicly accountable entities, rather than adopting IFRS for SMEs standard as is. Other jurisdictions have chosen to retain local Generally Accepted Accounting Principles (GAAP) and full IFRS alternatives in preference (ICAA, 2014, p. 2).

Due to the complexities and disagreements cited above, records indicate that amongst the countries who opted for IFRS for SMEs, many jurisdictions have given SMEs a choice between full IFRS and the local GAAP instead of IFRS for SMEs (see Figure 2.1) (IFRS Foundation, 2014a). For example, Israel has decided not to make the use of IFRS for SMEs mandatory due to the differences in measurement requirements between IFRS for SMEs and full IFRS. However, Israel intends to reconsider mandatory adoption after the first revision of IFRS for SMEs (IFRS Foundation, 2014a; UNCTAD, 2013). The Singapore Accounting Standards Council (ASC) has issued additional guidance to the Singapore Financial Reporting Standards (SFRS) equivalent to IFRIC 15 Agreements for the Construction of Real Estate. This guidance has been made as an integral part of the SFRS for Small Entities and is intended to be consistent with the requirements of IFRIC 15 of full IFRS (IFRS Foundation, 2014a).

As IFRS for SMEs is not appealing in its current state, some jurisdictions have decided to make significant modifications to the standard in order to conform to the requirements of full IFRS. For example, countries such as the United Kingdom and Ireland have modified the standard by adding (1) the revaluation option to revalue PPE and intangible assets, (2) an option to capitalize borrowing costs on qualifying assets, and (3) a timing difference approach to deferred income taxes rather than a temporary difference approach, etc. in order to mitigate the significant differences between the non-listed and listed entities (IFRS Foundation, 2014a). Pakistan is currently considering the adoption of IFRS for SMEs. However, Pakistan authorities will only consider adopting the standard by removing the differences in some recognition and measurement criteria, such as capitalization of borrowing cost on qualifying assets, revaluation option on PPE and valuation allowance of deferred tax assets (UNCTAD, 2013).

As evidenced by the existing literature on international reporting standards for SMEs, the implementation and adoption of IFRS for SMEs still seems to be controversial. The problems associated with the transformation process to a common set of international accounting standards, and the technical issues inherent in the recognition and measurement principles of the new standard, are expected to be a continuing challenge in achieving comparable global financial information produced by SMEs worldwide.

2.7 CONCLUSIONS AND IMPLICATIONS

The objective of this paper was to critically review IFRS for SMEs, including their development and implementation processes. Using the decision usefulness theory and the pecking order theory, the viability of the IASB's focus on enhancing decision usefulness and reducing the information asymmetry of financial information of SMEs was appraised in this paper. As suggested by the decision usefulness theory, an accounting regulatory framework needs to be derived through the financial information needs of the users at large. However, the analyses revealed that the user's orientation has not been adequately addressed by the IASB during the standard setting process of IFRS for SMEs. This infers that the IASB has followed an indeterminate basis for modifying and simplifying full IFRS principles and disclosure requirements for SMEs. In light of the cost-benefit considerations, SMEs may be hesitant in choosing IFRS for SMEs, if IFRS for SMEs do not clearly represent the user's information needs.

In accordance with the pecking order theory, internal sources of funding still appear to have primacy in the hierarchy of funding of SMEs and certain barriers to accessing external sources of capital move beyond the information asymmetry of financial information provided by SMEs. The analyses suggest that a proper mechanism would be required at individual jurisdiction level to safeguard the SMEs before they are exposed to global comparisons for accessing international competitive funds as envisaged by the IASB.

While many countries have adopted IFRS for SMEs, with or without modifications, there are still a number of prominent countries who have yet to adopt this set of standards. This study provides evidence that countries opposed to the adoption of IFRS for SMEs have identified many problems with it, including the perceived burden for small and micro-entities, inconsistencies with reporting frameworks at a national level and difficulties in the adoption process. Furthermore, technical difficulties inherent in certain sections of IFRS for SMEs and their potential complexity in the preparation of financial statements were also outlined. Countries have also highlighted the existence of inconsistency in the "true and fair view" principle among entities in the same jurisdiction if different reporting requirements, as specified by full IFRS and IFRS for SMEs, are applied. Therefore, adopting IFRS for SMEs appears to be challenging, with several practical difficulties in their implementation.

Though it is obvious that IFRS for SMEs are a simplified version of full IFRS, the application of this set of standards still seems to be burdensome for small and micro-entities, especially micro-entities. Countries that adopt locally developed GAAP, in particular, seem reluctant at present to accept IFRS for SMEs for this specific reason. The necessity of enforced international reporting standards for smaller and micro-entities still remains uncertain, and there may be a need for further simplification or for a fully simplified set of new standards which address the modest financial accounting needs of micro-entities.[20]

The interpretation of the eligibility of entities to adopt IFRS for SMEs and the title of the new standard itself has also created controversy. If the "size-threshold" is used as a common indicator to separate small and medium-sized entities from large enterprises, embarrassment might be created among entities regarding their eligibility to apply this set of standards. A controversial issue would be that large private entities with no public interest could also apply IFRS for SMEs though they do not yet belong to the SME category. Therefore, it may be necessary to create an alignment between the quantitative and qualitative criteria—the "size" and "non-listed status" of an entity (as decided in Brazil), to minimize the difficulties associated with the interpretation of which entities are eligible to apply IFRS for SMEs. Furthermore, a single set of reporting standards would be difficult to implement across all SMEs, which are defined differently across the globe.

[20] The IASB, in consultation with the SME Implementation Group (SMEIG), has developed and published guidelines to help micro-entities apply IFRS for SMEs.

As far as the cost implications in adopting IFRS for SMEs are concerned, the preparation of financial statements under the new standard is said to be cost-effective, with IFRS for SMEs having significantly reduced disclosure requirements compared to full IFRS. This might be true if a transition is made from full IFRS to IFRS for SMEs. At present, SMEs in many countries prepare their financial statements based on local GAAP requirements, so the transition from local GAAP to IFRS for SMEs may therefore increase the cost of the preparation of financial statements. Costs associated with training, changes to the existing systems/packages, the re-establishment of financial statements, extra consultation, and so on would also be onerous for SMEs adopting IFRS for SMEs. Thus, the precise effect on the cost-benefit considerations of such simplification in the recognition and measurement requirements of IFRS for SMEs is uncertain.

The implementation of two versions of international financial reporting standards (full IFRS and IFRS for SMEs) in the same jurisdiction may present certain difficulties for entities. Differential reporting may also pose difficulties if an entity that has adopted IFRS for SMEs wishes to shift to full IFRS. Some countries are more concerned with the issue of compatibility of international standards with local legislation, because offering an option to adopt full IFRS, local GAAP or IFRS for SMEs according to requirements or discretion would create future complications in terms of the comparability of financial statements across various business categories. These complications present challenges to the implementation of IFRS for SMEs given the many national and cultural diversities around the world.

Certain limitations of this study need to be acknowledged. The discussion on the implementation issues of IFRS for SMEs was based on prior studies that reported the transformation of the full set of IFRS, IFRS for SMEs, and recent information published by IFRS Foundation and prominent professional accounting bodies on the implementation of IFRS for SMEs. This may limit the scope of the study; however, based on the conceptual and practical issues identified, future research could be undertaken in various jurisdictions to reveal the actual implementation difficulties and issues encountered at the country and/or regional level in the adoption of IFRS for SMEs. From the perspective of those countries that have already adopted the new standard, future studies could also investigate the cost-benefit considerations of IFRS for SMEs.

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Table 2.1: Size threshold for SMEs worldwide

	Region/ Country	Micro Enterprise		Small Enterprise		Medium Enterprise		Remarks
		Employee Headcount	***Total Assets/Total Annual Turnover***	***Employee Headcount***	***Total Assets/Total Annual Turnover***	***Employee Headcount***	***Total Assets/Total Annual Turnover***	
	European Union	< 10	≤ € 2 million and ≤ € 2 m	< 50	≤ € 10 million and ≤ € 10 m	< 250	≤ € 43 million and ≤ € 50 m	
APEC	**Australia**	< 4		< 19		20 – 199		
APEC	**Canada**			< 100 employees for manufacturing < 50 employees for service		< 500 employees		
APEC	**Korea**	≤ 10 employees for manufacturing		≤ 50 employees for manufacturing		<300	Capital worth $8 million for manufacturing	
APEC		**Manufacturing & Others**		**Wholesale**		**Retail**		**Services**
APEC	**Japan**	≤ 300	Capital Size ¥ ≤ 300 m	≤ 100	Capital Size ¥ ≤ 100 m	≤ 50	Capital Size ¥ ≤ 50 m	≤ 100 employees Capital Size ¥ ≤ 50 m
	India		<Rs. 25 Lakhs investment in plant & machinery		< Rs.5 Crore – >Rs. 25 Lakhs investment in plant & machinery		< Rs.10 Crore – >Rs. 5 Crore investment in plant & machinery	Applies to Manufacturing & Production Enterprises
	India		<Rs. 10 Lakhs investment in equipment		<Rs. 2 Crore – >Rs. 10 Lakhs investment in equipment		<Rs. 5 Crore – >Rs. 2 Crore investment in equipment	Applies to Service Enterprises
	Bangladesh	10 – 24 or less	Assets worth Tk 5 - 50 Lakh	25 – 99	Assets worth Tk 50 Lakh to Tk 10 Crore	100 – 250	Assets worth Tk 10 – 30 Crore	Applies to Manufacturing Enterprises
	Bangladesh	10 or less	Assets worth Tk 5 Lakh or less	10 – 25	Assets worth Tk 5 Lakh to Tk 1 Crore	50 – 100	Assets worth Tk 1 – 15 Crore	Applies to Service Enterprises
	Bhutan	< 5	Investment capital less than NU 1 million	5 – 19	Investment capital between NU 1 – 10 million	20 – 99	Investment capital between NU 10 – 100 million	
	Nepal				Fixed assets up to Rs. 30 million		Fixed assets between Rs. 30 – 100 million	
	Maldives	up to 5	Annual income of MRF 500,000	6 – 30	Annual income between MRF 500,001 – 5,000,000	31 – 100	Annual income between MRF 5,000,001 – 20,000,000	As defined by Ministry of Economic Development
South Asia	**Sri Lanka**	SMEs are defined as enterprises with a capital investment of less than Rs. 5 million which employ fewer than 50 employees						As defined by Department of Small Industries
South Asia	**Sri Lanka**	SMEs are defined as enterprises with a capital investment of less than Rs. 20 million in plant, machinery and equipment excluding land and buildings, an annual turnover not exceeding Rs. 40 million, and a total annual turnover not exceeding Rs. 100 million						As defined by The Export Development Board
South Asia	**Pakistan**	SMEs are defined as enterprises whose employment size is up to 250, with paid up capital to Rs. 25 million and an annual sales value up to Rs. 250 million.						As defined by Government of Pakistan

Source:

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Table 2.2: Major differences between IFRS for SMEs and full IFRS

IFRS for SMEs		IFRS Equivalent	Key areas of differences between IFRS for SMEs and IFRS
Section	**Topic**		
6	Statement of Changes in Equity and Statement of Income and Retained Earnings	IAS 1 *Presentation of Financial Statements*	"Statement of Income & Retained Earnings" is a new statement incorporated into IFRS for SMEs. A statement of income and retained income may be presented in place of the statement of comprehensive income and statement of changes in equity, if the only changes to equity comprise profit or loss, payment of dividends, corrections of prior year errors and changes in accounting policy.
10	Accounting Policies, Estimates and Errors	IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*	If IFRS for SMEs does not specifically address a transaction, other event or condition, an entity's management shall use its judgment in developing and applying an accounting policy. In making the judgment, management shall refer to, and consider the applicability of: (a) the requirements and guidance in IFRS for SMEs dealing with similar and related issues; and (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 *Concepts and Pervasive Principles*. Management may also consider the requirements and guidance in full IFRS dealing with similar and related issues, but not mandatory.
11-12	Basic Financial Instruments and Other Financial Instruments Issues	IAS 39 *Financial Instruments: Recognition and Measurement*	An embedded derivative is separated from the host contract and accounted for as a derivative under IAS 39 under certain conditions. There is no concept of embedded derivatives under IFRS for SMEs. Derecognition and Hedging requirements have been simplified.
14-15	Investments in Associates and Investments in Joint Ventures	IAS 28 *Investments in Associates and Joint Ventures*	A venturer shall account for all of its interests in jointly controlled entities using either: (a) the cost model; (b) the equity method; or (c) the fair value model. However, IFRS for SMEs permits the use of the cost model only if a published price quotation is not available, otherwise use of the fair value is permitted.
16	Investment Property	IAS 40 *Investment Property*	Under subsequent measurement, an investment property whose fair value can be measured reliably without undue cost or effort must be measured at fair value at each reporting date with changes in fair value recognized in profit or loss. An entity accounts for all other investment property as property, plant and equipment using the cost-depreciation-impairment model in Section 17.
17	Property, Plant & Equipment	IAS 16 *Property, Plant & Equipment*	An entity must measure all items of property, plant and equipment after initial recognition at cost less any accumulated depreciation and any accumulated impairment losses. Only the historical cost method is permitted, no revaluations. However, the amendments to IFRS for SMEs have included the option to use the revaluation model for PPEs with effect from 1 January 2017.
18-19	Intangible Assets other than Goodwill and Business Combinations & Goodwill	IAS 38 *Intangible Assets*	Under IFRS for SMEs, in subsequent measurement, intangible assets are measured at cost less accumulated amortization and impairment losses. It does not permit the application of the revaluation model to intangible assets. Goodwill and intangible assets are amortized over its useful life. If a reliable estimate of useful life cannot be made, the life is presumed to be 10 years. However, the amendments to IFRS for SMEs require that if a reliable estimate of the useful life cannot be made, management must use their best estimate which shall not exceed 10 years.

20	Leases	IAS 17 *Leases*	Additional guidance is given on operating leases. Operating leases are expensed on a straight-line basis or another basis that represents the use of the asset, unless payments to the lessor increase with expected inflation, in which case the payments are expensed when payable.
24	Government Grants	IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*	An entity shall recognize government grants according to the nature of the grant as follows: a) A grant that does not impose specified future performance conditions on the recipient is recognized in income when the grant proceeds are receivable. b) A grant that imposes specified future performance conditions on the recipient is recognized in income only when the performance conditions are met. c) Grants received before the income recognition criteria are satisfied are recognized as a liability and released to income when all attached conditions have been complied with. Grants are measured at the fair value of the asset received or receivable.
25	Borrowing Costs	IAS 23 *Borrowing Costs*	All borrowing costs are expensed in profit or loss in the period in which they are incurred.
26	Share-Based Payments	IFRS 2 *Share-Based Payments*	IFRS for SMEs uses a hierarchy to determine the fair value of shares issued based on: a) Observable market prices. b) If unobservable, entity specific observable market data, such as a recent transaction in the instruments or a recent independent valuation of the entity. c) If the fair value is not observable and obtaining entity specific market data is impracticable, the directors should use their judgment to apply the most appropriate valuation methodology.
28	Employee Benefits	IAS 19 *Employee Benefits*	All actuarial gains and losses must be recognized in full either in profit or loss or in other comprehensive income. Post-retirement defined benefit plans recognition and measurement are significantly different to IFRS.
29	Income Tax	IAS 12 *Income Taxes*	Deferred tax assets have to be recorded under IFRS for SMEs with offsetting valuation allowances (this is not included in IAS 12). “Uncertain tax positions” recognition and measurement have been incorporated in IFRS for SMEs. However, the amendments have aligned the main recognition and measurement requirements for deferred income tax with IAS 12 *Income Taxes* with effect from 1 January 2017.
30	Foreign Currency Translations	IAS 21 *The Effects of Changes in Foreign Exchange Rates*	Exchange differences on monetary items are recognized in profit or loss for the period except for those differences arising on a monetary investment in a foreign entity (subject to strict criteria of what qualifies as net investment). In the consolidated financial statements, such exchange differences are recognized in other comprehensive income and reported as a component of equity.

Source: Ernst & Young (2010); IASB (2009a); IFRS Foundation (2015a)

Table 2.3: Examples of countries which have adopted/planned to adopt IFRS for SMEs

Region	Countries
South America	Argentina, Brazil, Chile, Colombia, Ecuador, Guyana, Peru and Venezuela
Caribbean	Anguilla, Antigua & Barbuda, Bahamas, Barbados, Dominica, Dominican Republic, Jamaica, Montserrat, Saint Lucia, St Kitts-Nevis, St Lucia and Trinidad & Tobago
Central America	Belize, Costa Rica, El Salvador, Grenada, Guatemala, Honduras, Nicaragua, Panama, St Vincent and the Grenadines
Africa	Botswana, Ghana, Kenya, Lesotho, Mauritius, Nigeria, Rwanda, Sierra Leone, South Africa, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe
Asia	Bangladesh, Cambodia, Fiji, Hong Kong, Maldives, Myanmar, Philippines, Singapore and Sri Lanka
Middle East	Bahrain, Iraq, Israel, Jordan, Saudi Arabia, United Arab Emirates and Yemen
Eurasia	Azerbaijan and Turkey
Europe	Armenia, Georgia, Herzegovina, Ireland, Macedonia, Serbia, Switzerland and United Kingdom

Source: IFRS Foundation (2014a)

Table 2.4: Proposed directive simplification – European Commission

The proposal has introduced a specific regime for small companies that will considerably reduce the administrative burden currently borne by small companies when they prepare their financial statements. It has reduced the disclosures by way of notes to the accounts to:

(i) accounting policies;
(ii) guarantees, commitments, contingencies and arrangements that are not recognized in the balance sheet;
(iii) post-balance sheet events not recognized in the balance sheet;
(iv) long-term and secured debts; and
(v) related party transactions. It should be noted that mandating the disclosure of items (iii) and (v) will result in new obligations imposed for small companies, as a majority of Member States have provided for exemptions from these disclosures for such companies.

The Proposed Directive also aims:

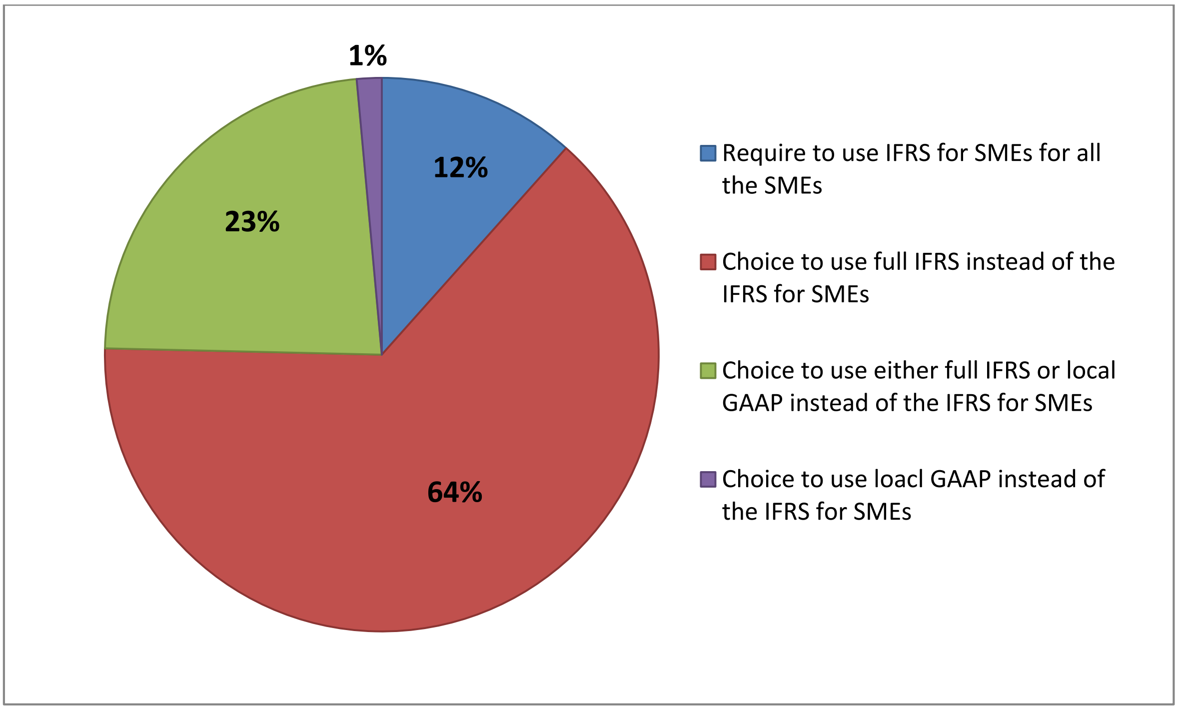
(i) to harmonize thresholds to ensure that the administrative burden reduction actually reaches all small companies in the EU. Currently many companies that are small under EU definitions enter the medium-sized or large company category; and
(ii) to improve the comparability and clarity of financial statements prepared by medium-sized and large companies, and by small companies to a limited extent. General principles such as "substance over form" become mandatory so as to increase the clarity of financial statements.

The EC has recommended small companies to:

(i) impose no requirements for a statutory audit; and
(ii) exempt small groups from preparing consolidated financial statements.

Source: EC Explanatory Memorandum (2011, pp. 6-7)

Figure 2.1: Application status of IFRS for SMEs in countries that have adopted the standard



Source: IFRS Foundation (2014a)

CHAPTER 3

(PAPER 2)

Confirmation Bias in the Reporting Judgments of Accountants When Applying International Financial Reporting Standards (IFRS) For Small and Medium-Sized Enterprises (SMEs)

ABSTRACT

This study conducts an experiment that investigates confirmation bias in the reporting judgments of accountants when applying International Financial Reporting Standards (IFRS) for small and medium-sized enterprises (SMEs). In particular, the study examines the likelihood that prior knowledge and beliefs about full IFRS influence the reporting judgments of accountants when applying IFRS for SMEs. This study also examines the likelihood that judgment justification requirements and the availability of decision aids assist in mitigating the confirmation bias that arises from prior knowledge and beliefs on full IFRS. The results indicate that the inability of accountants to choose the accounting treatment that best reflects the economic substance of a transaction when applying IFRS for SMEs is a function of the bias towards the recognition and measurement principles of full IFRS. The results also suggest that confirmation bias in judgments can be mitigated by increasing accountants' awareness of justification requirements and by using appropriately designed decision aids which contrast the differences in the recognition and measurement criteria between full IFRS and IFRS for SMEs. These results are likely to be of interest to the 70-plus countries that have adopted the SME standard and other countries that continue to contemplate the adoption of IFRS for SMEs.

Keywords: Confirmation bias, IFRS, SMEs, reporting judgment, judgment justification, decision aids.

3.0 INTRODUCTION

The International Financial Reporting Standards (IFRS) for small and medium-sized enterprises (SMEs) were issued by the International Accounting Standards Board (IASB) in 2009 to introduce a simplified version of full IFRS with significantly reduced recognition and measurement principles and disclosure requirements. This study examines the confirmation bias in the reporting judgments of accountants when applying IFRS for SMEs.[21] In particular, the study examines the likelihood that prior knowledge and beliefs about full IFRS influence the reporting judgments of accountants when applying IFRS for SMEs.[22] This study also examines the likelihood that judgment justification requirements and the availability of decision aids help to mitigate the confirmation bias that arises from prior knowledge and beliefs on full IFRS.

Diverse complications and controversial issues in the adoption of IFRS for SMEs have been reported by many jurisdictions. For example, prominent developed countries that have adopted the full set of IFRS, such as Australia, the United Kingdom and European Union member states, have yet to adopt IFRS for SMEs. The relevance and necessity of applying two different sets of standards in the same jurisdiction, in particular, have been questioned. Problems that may arise when certain accounting policies, recognition and measurement requirements are different across full IFRS and IFRS for SMEs are of major concern to prominent accounting institutions and accounting regulators (Australian Accounting Standards Board (AASB), 2012; EC Explanatory Memorandum, 2011). Australia is one of the first countries to declare that it will not adopt IFRS for SMEs, arguing that this standard has many inherent problems. Instead, a second tier of reporting requirements comprising full IFRS recognition and measurement and reduced disclosure similar to IFRS for SMEs has been implemented.

Canada has rejected the adoption of IFRS for SMEs for private enterprises, although Canada adopted full IFRS for all publicly accountable enterprises. The Accounting

[21] The psychological phenomenon whereby people manifest a strong tendency to confirm rather than disconfirm current beliefs and hypotheses in judgment and decision making is commonly referred to as confirmation bias.

[22] 'Prior belief' refers to a decision maker's beliefs on different values of an issue before the results of a study are evaluated (see Edwards & Smith, 1996; Lord, Ross & Lepper, 1979).

Standards Board (AcSB) in Canada has developed a separate financial reporting framework that is tailored to the needs of private enterprises (IFRS Foundation, 2015b). The AcSB is of the view that substantial deviations in recognition and measurement principles of full IFRS may result in inconsistent interpretations, which would adversely affect comparability and consistency. Further, the AcSB also points out that diversity of practice between private and publicly accountable entities may be more of a problem for practitioners who are involved in financial reporting practices of both private and publicly accountable entities (AcSB, 2008).

Similarly, the European Commission (EC) has kept the adoption of IFRS for SMEs within the European Union optional. There appears to be no strong objection to adopting the new standard; however, the EC is of the view that the objectives of simplification and reduction of administrative burden would not be served by IFRS for SMEs (EC Explanatory Memorandum, 2011). The European Financial Reporting Advisory Group (EFRAG) reports that IFRS for SMEs' conventions are incompatible with EU Directives (Fourth & Seventh) in several ways (EFRAG, 2010). This will result in financial statements prepared under IFRS for SMEs being neither comparable with financial statements prepared according to EU Accounting Directives nor with full IFRS financial statements (DGRV, 2010). In addition to the issues mentioned above, complexities arising from future changes to full IFRS and additional difficulties encountered by subsidiaries and companies planning transition to full IFRS are major concerns in Europe for not adopting IFRS for SMEs.

A key issue in adopting IFRS for SMEs is that a thorough understanding and awareness by accountants of the differences between the two sets of standards is required. Accountants' reporting judgments on IFRS for SMEs may be biased when the recognition and measurement requirements of IFRS for SMEs vary from those for full IFRS. For example, expensing all research and development costs and borrowing costs when they are incurred, recognising revenue of agreement for the construction of real estate, and the amortization of goodwill over their useful life in a business combination, are some of the significant deviations from the provisions of full IFRS. Accountants in many nations (i.e., 120 plus countries) had been educated and trained to apply full IFRS for a number of years prior to IFRS for SMEs coming into effect. Bias towards prior beliefs about full IFRS may hinder the ability of accountants to choose the accounting treatment that best reflects the economic substance of a transaction when applying IFRS for SMEs. This also implies that accountants will not perceive IFRS for SMEs as being a stand-alone document.

The IASB has widely adopted the principles-based approach in setting their accounting standards. Tweedie (2007) observed that the true-and-fair override embedded in the principles-based approach in IFRS requires the application of professional judgment. There is also the extensive use of professional judgment in the principles-based approach to IFRS in the simplified nature of IFRS for SMEs. In assessing the merits and challenges of using principles-based IFRS for SMEs, no attention has been paid to the notion that accountants might not be able to apply the simplified accounting policies, recognition and measurement requirements in IFRS for SMEs independent of their prior knowledge and beliefs about full IFRS. The human tendency to dislike change and to prefer to continue with past practices can result in misleading financial reporting if accountants incorrectly apply their prior knowledge and beliefs about full IFRS in the context of IFRS for SMEs. The established body of evidence in psychology and audit literature that pertains to bias in judgments associated with a decision maker’s prior knowledge and beliefs provides a strong rationale for examining this issue and to provide both a practitioner and theoretical contribution on the impact of prior knowledge and beliefs about full IFRS on financial reporting for SMEs.

Prior judgment and decision making research suggests that decision makers often search their long-term memory (pre-existing knowledge structures) to retrieve evidence about current matters (Birnberg & Shields, 1984; Choo & Trotman, 1991). In the process of retrieving prior knowledge for subsequent decision making, there is a tendency to confirm rather than disconfirm currently held beliefs and hypotheses about a transaction or event, commonly referred to as confirmation bias (Waller & Felix, 1984). This phenomenon can also bias the reporting judgments of accountants when using IFRS for SMEs. Based on the argument that accountants hold strong prior knowledge about full IFRS, the subsequent reporting judgments of accountants on IFRS for SMEs may be biased towards full IFRS where the recognition and measurement requirements are different across the two sets of standards in identical cases or transactions. An examination of this issue will be useful for all the nations (i.e., 70 plus countries) that have already adopted IFRS for SMEs, and who are seeking ways to enhance the judgments of their accountants and potentially improve the quality of financial reporting for SMEs in their respective jurisdictions.

To explore these issues and examine the impact of prior knowledge and beliefs on full IFRS on financial reporting for SMEs, an experiment is conducted in which experienced accountants are placed in a revenue recognition decision context. Judgment justification in the hypothetical scenario is manipulated between participants, who are either required or not required to justify their judgments. The availability of a decision aid is manipulated between participants and participants were either provided or not provided with the differences in revenue recognition criteria between full IFRS and IFRS for SMEs.

The first hypothesis presumes that the tendency to confirm prior knowledge and beliefs about the full set of IFRS will bias the reporting judgments of accountants when applying IFRS for SMEs. The results indicate the presence of confirmation bias towards the full set of IFRS in financial reporting for SMEs. As expected, the inability of accountants to choose the accounting treatment that best reflects the economic substance of a transaction when applying IFRS for SMEs is a function of the bias towards the recognition and measurement principles of full IFRS. The second and third hypotheses examine the potential role that the judgment justification requirement and the availability of decision aids play in mitigating the confirmation bias arising from prior beliefs about full IFRS. The results suggest that confirmation bias in judgments can be eliminated by increasing accountants' awareness of the justification requirements. The results also indicate that confirmation bias in judgments can be eliminated by the use of appropriately designed decision aids which contrast the differences in the recognition and measurement criteria between full IFRS and IFRS for SMEs.

This study contributes to the important debate on whether IFRS for SMEs have the potential to improve the quality of financial reporting for SMEs. The findings indicate that accountants are yet to shift their mindset and accept IFRS for SMEs as a stand-alone set of standards. The results of this study imply that countries adopting IFRS for SMEs can only reap benefits if the necessary investment in accounting education and training is made so that accountants are able to differentiate between the recognition and measurement criteria of full IFRS and IFRS for SMEs. These outcomes bring into question the argument that adopting IFRS for SMEs ensures better reflection of economic reality in financial reporting for SMEs.

The remainder of the paper is organized as follows. Section 3.1 provides the background and Section 3.2 outlines the relevant literature and develops the hypotheses. Sections 3.3 and 3.4 describe the experiment used to test the hypotheses and present the results. Section 3.5 provides a summary and offers the conclusions and implications of the study.

3.1 BACKGROUND

The IASB promulgated a simplified version of full IFRS as a regulatory remedy in response to the strong international demand to reduce the complexity and administrative burden of SME financial reporting (IASB, 2009a). By preparing financial statements in accordance with simplified IFRS for SMEs, the IASB anticipates that the objectives of generating high quality financial information and enhancing the comparability of financial statements between SMEs across the globe will be achieved. Realizing these objectives seems to be challenging for practising accountants because several arguments against the simplified IFRS for SMEs have been made since their publication in 2009.

The need for general comparability between full IFRS and IFRS for SMEs received a great deal of attention during the initial comprehensive review of IFRS for SMEs carried out by the IASB in late 2012 (AASB, 2012; Association of Chartered Certified Accountants (ACCA), 2012). The comment letters sent by many prominent accounting institutions and accounting regulatory bodies during this comprehensive review substantiate the implications of the differences in accounting policies, principles and accounting treatment between full IFRS and IFRS for SMEs, and their adverse effects on the consistent interpretation and application of the standards (AASB, 2012; ACCA, 2012). Regardless of the cost-benefit reasons for applying IFRS for SMEs, many prominent accounting institutions and accounting regulatory bodies have seen simplification in IFRS for SMEs as an unnecessary departure from the principles and practices of full IFRS (AASB, 2012; ACCA, 2012).

Emphasis has moreover been placed on the limitations of implementing two sets of standards in the same jurisdiction. If two sets of standards exist, one set (possibly the simplified set of standards) will inevitably have second class status. Accounting education will also be affected, because two different accounting principles have to be taught (ACCA, 2012). The continuous amendments made to full IFRS and the extent to which these amendments are required to be incorporated in IFRS for SMEs have also been seen as challenging. For example, IFRS 10 *Consolidated Financial Statements* has recently been updated, with changes made to some aspects of the definition of control. Such differences in definitions between the two standards may create more interpretation difficulties (ACCA, 2012).

The many criticisms of IFRS for SMEs are limited to certain discussions and reviews, and there is a lack of empirical evidence on the effects on the judgments of accountants of the differences between the two sets of standards. Further, even though prominent accounting institutions and accounting regulatory bodies show that the consistent interpretation and application of IFRS for SMEs are affected by the differential reporting framework introduced by the IASB, the possible consequences of prior knowledge and beliefs about full IFRS on the reporting judgments of IFRS for SMEs have not yet been adequately addressed. Attending to these issues is nevertheless considered to be imperative, because the differences between the two sets of standards may pose challenges to practising accountants when there are substantial deviations from the traditionally applied accounting policy options in full IFRS.

3.2 LITERATURE REVIEW AND HYPOTHESES

3.2.1 Prior knowledge and beliefs, and confirmation bias in judgment and decision making

Confirmation bias can take different forms but this study draws upon relevant literature on the remembrance and retrieval of experience-based prior knowledge and beliefs in judgment and decision making. The experience-based knowledge acquisition process develops cognitive structures that organise an individual's declarative and procedural knowledge in long-term memory. An accountant's declarative knowledge of recognition, measurement and disclosure principles is acquired through the formal education system. The repeated application of declarative knowledge in accounting practice transforms this knowledge into procedural knowledge. An accountant's adaptation of procedural knowledge gained through repeated application or experience results in the development of strong schemata about different accounting transactions. These schemata assist in organising experience and creating cognitive activities such as comprehension, remembrance, explanation and prediction (Waller & Felix, 1984).

Figure 3.1 shows that the schemata act like beliefs or hypotheses that guide the selection and comprehension of environment stimuli through which prior knowledge is retrieved in a new experiential context. In validating the goodness of fit between schemata that reflect beliefs or hypotheses and current experiential evidence, schemata tend to confirm rather than disconfirm the evidence (Waller & Felix, 1984). In retrieving evidence and data from long-term memory, the initial activation of memory presumably mainly retrieves prior beliefs, whereas the deliberate memory search retrieves material that refutes arguments that are themselves incompatible with an individual's prior beliefs, resulting in a confirmation bias in the individual's conclusions (Edwards & Smith, 1996).

The existing literature has widely documented the existence of confirmation bias in the judgments of individuals that is compatible with their prior knowledge and beliefs in various contexts.

Research investigating taxation judgments consistently finds that tax professionals exhibit confirmation bias towards their prior knowledge and beliefs about clients and relevant tax laws. For example, Cloyd (1995) provides evidence that prior knowledge and beliefs about clients and relevant tax law affect tax professionals' information search and evidence evaluation behaviours in performing a tax research task. They further reveal that the attention devoted to relevant information, speed of information retrieval and the ability of discriminating relevant vs. irrelevant information are also affected by prior knowledge and beliefs. Wheeler and Arunachalam (2008) also report the existence of confirmation bias in a tax research task. The subjects in their experiment were exposed to a multi-step tax research task which required them to collect and assess tax evidence in relation to a bonus pay issue in corporate taxation. Their findings provide evidence that tax professionals preferentially select information in support of the tax position recommended during planning (i.e. preferential selection of evidence to support one's prior beliefs), which results in confirmation bias when tax research is conducted for clients.

Several studies have documented that auditors rely on prior knowledge and beliefs on various issues when they exercise judgments. In particular, the prior knowledge of experiences stored in long-term memory and its implications for audit judgment when retrieving information for current applications is evident. In explaining the cognitive process of auditors learning from experience, Waller and Felix (1984) indicate that when forming inductive arguments regarding financial statement assertions, auditors prefer to seek confirmatory evidence rather than disconfirmatory evidence in their belief system.

Both Jeffrey (1992) and Tan (1995) have shown that repeat audit engagements instigate bias in audit judgments due to auditors’ reliance on prior evidence. Jeffrey (1992) argues that prior involvement has adverse consequences when an individual is overconfident in their knowledge, ability and judgment, and thus commits to behavioural acts that result in judgment bias. The study examines whether auditors’ personal involvement in repeat audit engagements may induce a tendency to make subsequent decisions conform to their prior loan evaluation decisions. The findings reveal that auditors’ personal involvement in repeat loan evaluation tasks has a negative effect on the decision-making process, encouraging them to make judgments that are biased towards their previous judgments on loan collectability.

Tan (1995) investigated the impact of prior expectations, prior audit involvement and review awareness on the judgment process of auditors. In particular, the study compares the prior audit involvement condition with the memory of the different types of audit evidence recalled and the judgment made for a financial viability prediction task. The finding confirms the existence of auditors’ high reliance on memory for consistent evidence that arises from repeat audit engagement. The study also provides evidence that auditors with prior audit involvement deviate less from prior-year judgments when undertaking audit for the current year than auditors without that experience.

As expounded in the literature, it is apparent that much of the information that individuals use is stored in memory and retrieved as needed, and that this experience-based knowledge is fundamental to the exercise of professional judgment in many decision-making contexts. Bias in judgments associated with the recall and retrieval of previously encountered information (mostly prior knowledge and beliefs engendered through experience) in judgment and the decision making process is also evident. While studies have been conducted in psychology, auditing and taxation contexts, research investigating the bias associated with prior knowledge and beliefs in the context of IFRS reporting is absent. This study fills this void by examining whether accountants' prior knowledge and beliefs about full IFRS will bias their reporting judgments when interpreting and applying IFRS for SMEs.

3.2.2 Effect of prior knowledge and beliefs about full IFRS on reporting judgments of accountants when interpreting and applying IFRS for SMEs (H1)

Schank (1999) argued that individuals continue to reorganize information in their memory as new experiences accumulate. His Theory of Dynamic Memory indicates that in understanding an input, an individual will find the closest approximation to the input from their past experience and then code the input in terms of the previous memory by means of an index. Individuals use a memory index when storing new information, retrieving existing knowledge, and creating new indices for novel information. In this process, the more similar problems individuals encounter in a related task, the greater the number of comparisons with prior experiences, and the stronger the prior experiences, the more new indices are stored in their memory (see Kopp & O'Donnell, 2005 for further analysis on Schank's theory). Prior studies have also found that an individual can abstract the underlying features of a problem even from studying only one example, and can then use this knowledge to solve new problems (see Chand, Patel, & Patel, 2010; Earley, 2001 for a review of these studies).

To examine the confirmation bias in SME reporting, the study selects the revenue recognition decision context for the construction of real estate where the recognition and measurement requirements are different across full IFRS and IFRS for SMEs. International Accounting Standard (IAS) 18 *Revenue* paragraphs 14 and 20 includes the general principles for the recognition of revenue, primarily based on the criterion of whether the entity has transferred to the buyer the 'significant' risks and rewards of ownership of the goods and when the outcome of a transaction can be reliably measured.

Furthermore, in recognising a real estate construction agreement as an agreement for the sale of goods, IFRS Interpretations Committee (IFRIC) 15 *Agreements for the Construction of Real Estate*, paragraph 17 in full IFRS specifies that 'the entity may transfer to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses' (IFRS Foundation, 2008, p. 1324). In this case, if all the criteria in paragraph 14 of IAS 18 are met as construction progresses, revenue is recognised by the entity by reference to the stage of completion, using the percentage of completion method (IFRS Foundation, 2008).[23]

In contrast, Section 23 *Revenue* paragraph 23.A.15 of IFRS for SMEs promotes the end of completion method for revenue recognition and the examples specify that 'the buyer does not obtain control or the significant risks and rewards of ownership of the work in progress in its current state as construction progresses' unless certain criteria are satisfied (IASB, 2009a, p. 144).[24] These differences in recognition and measurement requirements between the two sets of standards require accountants to exert judgment differently.

The study predicts that when accountants interpret and apply IFRS for SMEs, they will search their long-term memory to retrieve evidence about transactions or events. The study argues that accountants hold strong prior knowledge and long-standing beliefs about full IFRS and therefore their reporting judgments on IFRS for SMEs may be biased towards full IFRS, even though the recognition and measurement requirements in identical cases or transactions across the two sets of standards are different. Accordingly, the following hypothesis is formulated on the notion that an accountant manifests a strong tendency to confirm rather than disconfirm currently held knowledge and beliefs.

H1: It is likely that the tendency to confirm prior knowledge and beliefs about full IFRS will bias the reporting judgments of accountants when they interpret and apply IFRS for SMEs.

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[23] Revenue from the sale of goods shall be recognised when all the following conditions have been satisfied: (a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods; (b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold; (c) the amount of revenue can be measured reliably; (d) it is probable that the economic benefits associated with the transaction will flow to the entity; and (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably (IFRS Foundation, 2001a, p. 739).

[24] Section 23 *Revenue* of IFRS for SMEs specifies that an entity that undertakes the construction of real estate, directly or through subcontractors, and enters into an agreement with one or more buyers before construction is complete, shall account for the agreement as a sale of services, using the percentage of completion method, only if: (a) the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (whether it exercises that ability or not), or (b) the buyer acquires and supplies construction materials and the entity provides only construction services (IASB, 2009a, p. 144).

3.2.3 Effects of judgment justification on the financial reporting behaviour of accountants

Justification denotes the process of providing evidence and explanations to support one's beliefs about a judgment or decision (Bonner, 2007; Peecher, 1996). It has two main functions in the judgment and decision making process – uncertainty reduction and documentation (Emby & Gibbins, 1987). First, uncertainty reduction is the decision maker's desire for evidence at various stages of the decision-making process before a choice of action is made (Emby & Gibbins, 1987). If an individual is aware that their judgment or decision needs to be defended, a justification goal is incorporated into their intentional search and evaluation of information (Gibbins & Newton, 1994; Peecher, 1996). Second, justification documentation supports the decision-maker's ability to defend the chosen decision or action in light of the outcome (Emby & Gibbins, 1987). Imposing the justification requirement on the decision maker creates the stimulus to begin with an intentional search of information, with the purpose of defending their preferred decision. Such a stimulus might take the form of an incentive, an attention directive, a pressure, a motivation, an effort or a defensive bolstering.

The effect of justification on judgment performance has been widely examined in the audit context because auditors often work in an accountability-inducing environment (Kennedy, 1993; Shankar & Tan, 2006). Audit research regards auditors' awareness of justification requirements in the audit review process as a quality control mechanism that helps to eliminate bias associated with their audit judgments (Kennedy, 1993; Tan, 1995). For example, Kennedy (1993) conducted an experiment to explore the effect of the accountability of auditors in the form of justification of the audit review process on the mitigation of the recency effect in a going-concern evaluation context. The study concludes that effort-related bias can be mitigated by requiring auditors to be held accountable for providing justifications in the audit review process.

Tan (1995) also investigated whether auditors' awareness of the review process in audit decisions overcomes the judgment consistency effect associated with prior audit involvement. In their experiment, members of the treatment group were instructed to provide a short written memo to justify the basis for their evaluations after the financial viability task had been completed, and they were also instructed that a sample evaluation might be chosen at random to be reviewed by executive officers. It was expected that the awareness of a possible audit review would increase the auditors' vigilance. The result suggests that the auditors' awareness of the audit review process induces a form of social pressure that reduces the effect of judgment consistency resulting from prior audit involvement.

Research in the audit context also documents that justification requirements improve the accuracy and quality of audit judgments. Ashton (1992) examined the impact of justification requirements on consistency, accuracy and consensus in processing multiple pieces of information over a series of judgments. Auditors in his experiment performed a bond-rating prediction task under two treatment conditions, justification requirement and mechanical aid, and their impact on the consistency, accuracy and consensus of judgments was measured. The results provide evidence that the accuracy and quality of audit judgments are improved significantly when the justification requirements are specified before auditors engage with a judgment-related task.

Judgment justification generally provides increased motivation for vigilant information processing and better judgment performance (Tetlock, 1983). A decision maker expends a great deal of effort in defending the judgments or opinions made as a result of the pressure generated by the justification requirements, thus reducing the bias associated with those judgments and increasing the accuracy and consistency of judgments. A requirement to justify one's judgment induces pressure to search unbiased evidence and process information to increase accuracy by eliminating (or mitigating) the bias associated with their judgments. Findings from the literature suggest that various forms of bias in the judgment and decision making process, such as the recency effect, primacy effect and consistency effect, are moderated by the justification requirements. Nevertheless, there is a lack of evidence as to whether the justification requirements mitigate the confirmation bias arising from the effects of prior knowledge and beliefs about accounting standards on the financial reporting behaviour of accountants.

3.2.4 Effects of judgment justification requirements in mitigating the confirmation bias that arises from prior knowledge and beliefs on full IFRS (H2)

Most prior research explores the effects of justification on judgment and decision making from the auditors' standpoint, but there is limited evidence from the perspective of accountants – the preparers of financial reports. The subjectivity involved in a principles-based approach to IFRS stresses the need to induce a form of justification requirement in the judgment of preparers. For example, the principles in the new professional judgment framework developed by the Institute of Chartered Accountants of Scotland (ICAS) emphasises the need for proper documentation of the judgment by preparers, requiring them to appropriately justify why they agreed with the final solution rather than the alternative options available (ICAS, 2012). Therefore, the justification requirement obliges preparers to assess the accuracy of the judgments that have been made.

This study envisages that justification requirements can play an important role in enhancing the ability of accountants to choose the accounting treatment that best reflects the economic substance of a transaction when applying principles-based IFRS for SMEs. The study expects that accountants who are aware of the requirement to document their justifications will be motivated to put more effort into the judgment task. Their cognitive processing will increase because the justification requirements will create the stimulus to retrieve unbiased evidence and process all the pertinent information regarding the accountant's financial reporting decision in order to defend their preferred outcome.

On the other hand, accountants without a justification requirement may not conduct a careful memory search to choose appropriate recognition and measurement principles of IFRS for SMEs; instead, they may rely on evidence that will confirm their prior knowledge and beliefs about full IFRSs. Consequently, it is expected that the confirmation bias on judgments arising from the prior knowledge and belief effect will be mitigated as a result of accountants' justification requirements. Accordingly, the following hypothesis is formulated:

H2: A judgment justification requirement is likely to mitigate the confirmation bias arising from prior knowledge and beliefs about full IFRS when accountants interpret and apply IFRS for SMEs.

3.2.5 Effects of decision aids on the financial reporting behaviour of accountants

Decision aids can assist a decision maker in gathering, processing and analysing information and their use has been widely advocated as a judgment and decision making improvement tool (Bonner, 2007, p. 341). Various types of decision aids are available, ranging from simple written instructions to complex computer-based decision support systems. Regardless of the type of decision aids employed, prior research in general provides evidence that they impact positively on judgment performance. For example, Bonner (2007) notes that decision aids can assist individuals to enhance the efficiency and effectiveness of information search strategies, hypothesis formation and evidence evaluation, memory retrieval and cognitive processing in decision making.

The role that decision aids play in improving judgment performance has been widely reported in the auditing and taxation context. Audit judgment is often equipped with many forms of decision aids and many studies in this area have documented that they enhance the accuracy and consistency of auditors' judgments. Earlier studies, such as Boritz (1985) and Butler (1985), show the effects of a simple decision aid called a five-step decision aid procedure which helps auditors to make more accurate decisions. Kachelmeier and Messier (1990) conducted an experiment to test the effect of decision aids on the magnitude and variability of auditors' sample size judgments. The findings indicate that decision aids remove judgmental bias such as 'beliefs about small numbers' and result in more variations in auditors' judgments about sample size.

Ashton (1992) provides evidence that the availability of a mechanical aid improves the judgment performance of auditors. Similarly, Anderson, Kaplan and Reckers (1997) and Clarkson, Emby and Watt (2002) show that decision aids in the form of considering alternatives and additional guidance reduce hindsight bias. Likewise, Lowe and Reckers (2000) provide evidence that auditors who receive more guidance make better judgments about the need for inventory adjustments than auditors who are not provided with this guidance.

Wheeler and Arunachalam (2008) demonstrate that decision aids mitigate the confirmation bias when conducting tax research for clients and assist in making more accurate judgments. The results provide evidence that tax professionals demonstrate a preference for selecting information in support of their client, but that the use of a decision aid reduces bias in the selection and importance of information in support of the client, which leads to accurate judgments being made.

Prior studies have also examined the effects of two combined decision aids on an individual's judgment and decision making. Studies such as Bonner, Libby and Nelson (1996) and Ng and Tan (2003) provide evidence that the combination of two decision aids improves the judgment of auditors. For example, Bonner et al. (1996) examined the effect of a checklist aid and a mechanical-aggregation aid in applying experienced error frequencies to conditional probability judgments in audit planning. An experiment was conducted to examine the effectiveness of a checklist (a reminder of financial statement errors in the transaction cycle) and mechanical-aggregation aids (to assist in the retrieval and aggregation of conditional judgment) in alleviating a mismatch between task organisation and knowledge organisation. The findings suggest that auditors' judgment is improved by both decision aids, although the effect is more strongly reflected in the use of mechanical-aggregation aids than checklists, which helps to reverse the effect of the mismatch between knowledge organisation and task organisation.

Prior studies also indicate that improving judgment performance varies with the nature and quality of the decision aid provided and its relevance to the task. For example, Clarkson et al. (2002) evaluated the quality of auditors' judgments against two sets of debiasing instructions: weak and strong (but brief) instructions respectively. Participants were warned in the weak instructions to beware of the potential biasing effects of outcome information and its influence, whereas the strong instructions stressed the non-normativeness of incorporating outcome knowledge into evaluative judgments. The findings confirm that strong instructions are an effective debiasing technique for overcoming the outcome effect in an audit judgment setting, whereas weak instructions are not as beneficial. A number of studies have also shown that it is important to provide only a sufficient level of guidance to individuals because excessive guidance can lead to information overload and decisions of lower quality (see Snowball, 1980).

The application of different types of decision aids such as checklists, mechanical aids and non-statistical tools indicates the effectiveness of each type of decision aid in improving judgment performance. This study considers whether a decision aid can mitigate the confirmation bias arising from the effects of prior knowledge and beliefs of accounting standards on the financial reporting behaviour of accountants.

3.2.6 Effects of decision aid in mitigating the confirmation bias that arises from prior knowledge and beliefs on full IFRS (H3)

This study employs a written interpretation guideline as a decision aid to examine its effect on mitigating the confirmation bias in judgment and decision making. Generally, written instructions provide further explanation on how to make the relevant judgment, with the aim of enhancing the cognitive processing of a decision maker. In particular, written instructions reduce the effects of cognitive bias that occur as a result of searching the knowledge held in memory for evidence associated with earlier beliefs and hypotheses (Arkes, 1991; Bonner, 2007). An effective decision aid redirects a decision maker's attention, compelling them to adjust their customary approach of focusing on the elements of the specific decision-related issue (Butler, 1985). Consistent with the findings that the decision aid improves judgment performance, the study anticipates that providing accountants with a decision aid that contrasts the differences in interpretation guidelines between full IFRS and IFRS for SMEs will eliminate the reliance on full IFRS when exerting judgment using IFRS for SMEs.

There are very few well-designed decision aids for accountants to assist them in making financial reporting judgments. The interpretation guidance that accompanies the accounting standards in principles-based IFRS can be considered as one form of decision aid. Nevertheless, compared to full IFRS, IFRS for SMEs offer significantly less guidance. This study argues that by providing a decision aid in the form of an interpretation guideline that makes a clear distinction between the recognition and measurement principles of full IFRS and IFRS for SMEs can play an important role in enhancing the ability of accountants to choose the accounting treatment that best reflects the economic substance of a transaction when applying principles-based IFRS for SMEs.

The decision aid designed for the purpose of this study clearly contrasts the interpretation guidelines of full IFRS and IFRS for SMEs in relation to the recognition of revenues from the construction of real estate. It is expected that accountants who are provided with the interpretation guidelines would be able to clearly perceive the differences in the criteria for recognising the revenues from real estate construction contracts in full IFRS (IFRIC 15) and IFRS for SMEs (Section 23 *Revenue*) before making their judgment. Comparing the differences between the two sets of standards will enable accountants to make more accurate and unbiased judgments independent of their prior understanding of full IFRS.

On the other hand, accountants without the interpretation guidelines may not conduct a careful memory search to choose appropriate recognition and measurement principles of IFRS for SMEs; instead, they may rely on evidence that will confirm their prior knowledge and beliefs about full IFRS. Consequently, it is expected that the confirmation bias arising from the prior knowledge and belief effect on judgments will be mitigated as a result of the interpretation guideline provided to the accountants. This study therefore tests the following hypothesis:

H3: A decision aid in the form of an interpretation guideline is likely to mitigate the confirmation bias arising from prior knowledge and beliefs about full IFRS when accountants interpret and apply IFRS for SMEs.

3.3 EXPERIMENT

3.3.1 Participants and design

For the purpose of this study, the research setting should represent a country that applies both the full set of IFRS and IFRS for SMEs. Sri Lanka has taken the lead in adopting IFRS for SMEs in the Asia-Pacific region. Shortly after the standard was issued in 2009, all entities not identified as ‘large’ were required to comply with IFRS for SMEs for the reporting period beginning on or after 1st January 2012. The International Accounting Standards (IAS) had been applied in Sri Lanka since 1996, and in 2010 the Institute of

Chartered Accountants of Sri Lanka (ICASL) fully converged with IFRS and issued the Sri Lanka Financial Reporting Standards (SLFRS), the equivalent of IFRS.[25] The new SLFRS for SMEs is a completely stand-alone set of standards. The differential reporting setting in Sri Lanka provides an appropriate research setting for undertaking the current study.

The participants in the experiment were 92 qualified practising accountants who held Associate Chartered Accountant (ACA) qualification and Fellow Chartered Accountant (FCA) qualification from the ICASL with an average of five years of professional work experience in financial reporting. The participants had relevant education, training and experience in dealing with the Sri Lankan equivalents of full IFRS and IFRS for SMEs. Because the experiment asks participants to choose the accounting treatment that best reflects the underlying economics of transactions for an SME faced with a revenue recognition decision context, it was important to select Sri Lankan-based accountants who had experience in making financial reporting decisions in the context of IFRS for SMEs.

The experiment took place in a SLFRS seminar held for the practising members of the ICASL at the ICASL premises. The accountants who attended the seminar were requested to indicate their willingness to participate in the experiment. 92 accountants who indicated their willingness to participate in the experiment were randomly assigned to one of the three groups, with 33 participants in the control group, 30 participants in the justification group and 29 participants in the decision aid group.

To test the hypotheses, this study conducts the experiment requiring participants to make the revenue recognition decision for an SME. The revenue recognition decision context is selected for the construction of real estate where the recognition and measurement requirements are different across full IFRS and IFRS for SMEs.

Judgment justification in the hypothetical scenario is manipulated between participants, who are either required or not required to justify their judgments. The availability of a decision aid is manipulated between participants and they are either provided or not

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[25] The ICASL is the leading professional accounting body of Sri Lanka and has been entrusted with the authority to develop and issue accounting standards.

provided with the differences in revenue recognition criteria between full IFRS and IFRS for SMEs.

To preserve internal validity and to enable differences in the reporting judgments of accountants to be attributable to the three variables of interest (confirmation bias in the reporting judgments arising from prior knowledge and beliefs, judgment justification and decision aid), particular care was taken in designing the scenario. Potentially confounding variables that could affect the reporting judgments of accountants were controlled; for example, prior research suggests that incentives may have such a pronounced impact that the possible effect of confirmation bias arising from prior knowledge and beliefs on judgment could be diminished (see Cuccia, Hackenbrack, & Nelson, 1995). In the context of this study, no such incentives were provided to the accountants to influence their reporting judgments. For the given scenario, participants were simply instructed to choose the accounting treatment that best reflected the underlying economics of transaction for an SME faced with a revenue recognition decision. It was emphasized to the participants that they had to make a reporting judgment on behalf of the SME using IFRS for SMEs rather than full IFRS.

3.3.2 Procedures

The participants were provided with a research instrument containing two sections (Appendix 2). The first section required respondents to provide demographic data such as gender, age, level of formal education, employer details and years of work experience. The respondents were also asked to indicate their level of familiarity with the Sri Lankan equivalents of full IFRS and IFRS for SMEs (measured both by how familiar they were with full IFRS/IFRS for SMEs on a Likert scale where 1 denoted 'not familiar', and 4 denoted 'very familiar'; and how frequently they referred to these standards in their professional practice on a Likert scale where 1 denoted 'never', and 4 denoted 'often').

The first part of the second section included the case scenario. A practical scenario was developed in which participants had to make a reporting judgment on behalf of the SME. The scenario was based on accounting for revenues by entities that undertake the construction of real estate directly or through subcontractors. The hypothetical company is a medium-sized non-listed company which engages in the development of residential real estate and selling individual apartments. A buyer who enters into an agreement with the company is required to make progress payments at three completion stages between the time of the initial agreement and the contractual completion. The participants were required to provide a judgment on whether to use the percentage of completion method or the completed contract method in recognising the relevant revenue from the construction of the real estate for the SME.

To examine the confirmation bias in the reporting judgment of accountants when applying IFRS for SMEs, the study measures the extent to which the participants retrieved information consistent with their prior knowledge and beliefs about full IFRS. They were given a combination of ten revenue recognition criteria deduced from both full IFRS and IFRS for SMEs in the second part of Section 2. This consisted of six revenue recognition criteria from full IFRS and four revenue recognition criteria from IFRS for SMEs. Respondents were asked to select the relevant and irrelevant revenue recognition criteria in relation to the judgment they made by circling the rating choice on a ten-point Likert scale (where 1 denoted ‘irrelevant’ and 10 denoted ‘relevant’).

The first treatment group was the justification group, in which participants were required to provide a written justification for their reporting judgment, i.e. why they chose the percentage of completion method or the completed contract method in recognising the relevant revenue from the construction of the real estate for the SME. The respondents in this group were also instructed that some of them would be chosen at random to further explain and justify their judgment to a panel (which included the researchers).

Consistent with the literature, the manipulation check for judgment justification was conducted post-experiment using two questions (see Hatfield, 2000; Tetlock, 1983). Each manipulation check question was answered using a seven-point Likert scale. The first question sought to identify how motivated the accountants were to perform well on the given task, where 1 denoted ‘not at all’ and 7 denoted ‘extremely motivated’. The second question sought to identify how much effort the accountants expended on the given task, where 1 denoted ‘very little effort’ and 7 denoted ‘a great deal of effort’. Additionally, the respondents were asked to indicate the extent to which the requirement to justify the judgment enabled them to make a better judgment by circling the rating choice on a seven-point Likert scale (where 1 denoted ‘not at all’ and 7 denoted ‘to a great extent’).

The subjects in the second treatment group were provided with a decision aid to assist them in making their financial reporting judgment. This decision aid in the form of interpretation guidelines provided a clear distinction between the interpretation guidelines of full IFRS and IFRS for SMEs in relation to the recognition of revenues from the construction of real estate. Since the objective of including a decision aid was to examine whether it mitigates the confirmation bias arising from prior knowledge and beliefs about full IFRS, the decision aid was included before the scenario in the research instrument. The manipulation check for the decision aid was conducted post-experiment when participants were asked to indicate the extent to which the decision aid enabled them to make a better judgment by circling the rating choice on a seven-point Likert scale (where 1 denoted ‘not at all’ and 7 denoted ‘to a great extent’).

Further to providing their judgments on the scenario, the respondents were asked to indicate the extent to which they applied their prior knowledge of full IFRS to reach an appropriate judgment on the scenario by circling the rating choice on a seven-point Likert scale (where 1 denoted ‘not at all’ and 7 denoted ‘to a great extent’). Additionally, the respondents were asked to identify the perceived level of complexity of the scenario by circling the rating choice on a seven-point Likert scale (where 1 denoted ‘not complex’ and 7 denoted ‘extremely complex’). They were also asked to indicate their perceived level of familiarity in dealing with similar scenarios by circling the rating choice on a seven-point Likert scale (where 1 denoted ‘not familiar’ and 7 denoted ‘very familiar’).

3.3.3 Pre-test

To obtain an indication of the accounting treatment that best reflects the underlying economics of transaction and event in the financial statements (i.e., the most accurate judgment) of the scenario, a pre-test was conducted. The research instrument was pre-tested with three senior accountants and seven senior academics who also held professional accounting qualifications in Sri Lanka. Each participant in the pre-test group made their reporting judgment on the scenario with the help of the decision aid. The mean score of the judgment made by all the participants in the pre-test is an indication of judgment consensus amongst the participants, and the consensus in the judgment of experts was used as a proxy for judgment accuracy in the case (see Solomon & Shields, 1995).

Section 23 *Revenue* of IFRS for SMEs promotes the end of the completion method for revenue recognition. As specified in paragraph 23A.15, ‘if an entity is required to provide services together with construction materials to perform its contractual obligation to deliver the real estate to the buyer, the agreement shall be accounted for as the sale of goods. In this case, the buyer does not obtain control or the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. Rather, the transfer occurs only on delivery of the completed real estate to the buyer’ (IASB, 2009a, p. 144). According to the information provided in the given scenario, the condition to consider the agreement as sale of goods is satisfied because the company provides all the services and acquires all the materials required for the construction of the apartment. The revenue of this agreement can only be recognised on delivery of the completed real estate to the buyer. Consequently, the most accurate judgment in this scenario is that the revenue should be recognised using the completed contract method.

The mean score of the judgments made by all the participants in the pre-test was used to determine whether the SME should choose the percentage of completion method or the completed contract method in recognising the relevant revenue from the construction of the real estate. The mean score of the judgments made by all the participants in the pre-test group was 1.57 (non-tabulated), which indicated that the company should recognize the relevant revenue from the construction agreement using the completed contract method.[26]

Since the required judgment in the scenario is for an SME faced with a revenue recognition decision, the revenue recognition criteria from IFRS for SMEs Section 23 *Revenue* is considered as ‘relevant’ information that could influence the correctness of the judgment to be made. The revenue recognition criteria from full IFRS are considered as ‘irrelevant’ information that would have no influence on the correct judgment to be made in the scenario.

[26] Accountants were asked to record their judgment on whether the company could recognise revenue of the agreement using the percentage of completion method. They were asked to provide their judgment on the matter on a seven-point Likert scale (where 1 denoted ‘strongly disagree’ and 7 denoted ‘strongly agree’).

To provide an array of information that was either relevant or irrelevant, each participant in the pre-test group rated the ten revenue recognition criteria according to how relevant they were to making their judgment. The mean score for each item was used to determine whether each criterion was relevant (the criterion influenced the judgment of the participant) or irrelevant (the criterion was of no value when making a judgment). The four criteria with the highest mean scores (between 8.86 and 9.57) were selected as relevant information in this study. The six criteria with the lowest mean scores (between 1.71 and 2.14) were selected as irrelevant information in this study. Relevant information consists of the revenue recognition criteria that are relevant in making the judgment in accordance with IFRS for SMEs. Irrelevant information consists of the revenue recognition criteria that are included in full IFRS, but are irrelevant in making the judgment for an SME faced with a revenue recognition decision.

3.4 RESULTS

3.4.1 Demographic details of respondents

92 professional accountants participated in this experiment. As shown in Table 3.1, of the 33 respondents in the control group, 13 were male and 20 were female; of the 30 respondents in the justification group, 17 were male and 13 were female; and of the 29 respondents in the decision aid group, 19 were male and 10 were female. The mean age category of the respondents in each group was 32 years. The average number of years in formal education was 17 years for the respondents in each group. The average professional experience level was 5.36 years for the control group, 6.23 years for the justification group, and 4.77 years for the decision aid group.

The respondents in each group were familiar with the Sri Lankan equivalents of full IFRS as indicated by the mean response of 3.15 for the control group, 3.20 for the justification group and 3.38 for the decision aid group (on a Likert scale where 1 denoted ‘not familiar’, and 4 denoted ‘very familiar’). The respondents in each group were also familiar with the Sri Lankan equivalents of IFRS for SME as indicated by the mean response of 2.67 for the control group, 2.97 for the justification group and 2.69 for the decision aid group. The respondents in each group further indicated that they often refer to Sri Lankan equivalents of full IFRS in their professional practice as indicated by the mean response of 3.73 for the control group, 3.57 for the justification group and 3.72 for the decision aid group (on a Likert scale where 1 denoted 'never', and 4 denoted 'often'). The respondents in each group also indicated that they often refer to Sri Lankan equivalents of IFRS for SME in their professional practice as indicated by the mean response of 2.94 for the control group, 3.17 for the justification group and 3.07 for the decision aid group.

3.4.2 Tests of hypotheses

3.4.2.1 Confirmation bias in the reporting judgments of accountants (H1)

H1 is tested using one-way Analysis of Variance (ANOVA) where 'prior knowledge and beliefs about full IFRS' is the between-subject independent variable (confirmation biased group/unbiased group) with the accountant's revenue recognition decision serving as the dependent variable.

H1 predicts that the tendency to confirm prior knowledge and beliefs about full IFRS will bias the reporting judgments of accountants when they interpret and apply IFRS for SMEs. To examine the effect of confirmation bias arising from prior knowledge and beliefs about full IFRS, the respondents were dichotomized into a confirmation biased group/unbiased group using the median split. The net score of revenue recognition criteria retrieved by respondents was used for the purpose of categorisation.[27] A higher RIR denotes the retrieval of more relevant information in accordance with IFRS for SMEs (unbiased group) while a lower RIR denotes the retrieval of more irrelevant information in accordance with full IFRS (confirmation biased group). The ANOVA results with the dichotomized variable reveal that the accountants in the unbiased group are significantly more likely to make revenue classification decisions that best reflect the economic substance of a transaction (mean = 3.15) than the accountants in the confirmation biased group (mean = 5.30, $F = 27.110$, $p = 0.000$). These results in Table 3.2 provide support for H1.

To further explore the confirmation bias in judgment when accountants interpret and apply IFRS for SMEs, the respondents were dichotomized into a biased judgment group/unbiased

[27] The difference between the sum of relevant information and the sum of irrelevant information (RIR) is calculated by subtracting the total scores of irrelevant information from the total scores of relevant information selected by individual subjects. The RIR score ranges from -56 (Lowest) to 34 (Highest).

judgment group using the median split of their reported judgments. A Single-Sample Binomial Test was used to measure whether the proportion of participants falling into each category differs from a pre-defined probability (0.50) of falling into one of these two categories. The results indicate that the proportion of respondents falling into the category of biased judgment group differs significantly ($p = 0.009$) from the hypothesised value of 50%. These results in Table 3.3 further support H1, indicating the presence of confirmation bias in the judgments of the accountants.

3.4.2.2 Effect of judgment justification in moderating the impact of confirmation bias in the reporting judgments of accountants (H2)

Two manipulation check questions were designed to verify the respondent's justification requirements. In the first question, the respondents were asked to indicate how motivated they were to perform well on the given task on a seven-point Likert scale (where 1 denoted 'not at all' and 7 denoted 'extremely motivated'). The ANOVA results indicate that the accountants in the justification group were more motivated to complete the task well (non-tabulated mean = 5.33) than the accountants in the control group, i.e. those who were not required to provide a justification for their judgment (non-tabulated mean = 4.55, $F = 7.360$, $p = 0.009$).

In the second manipulation check question, the respondents were asked to indicate how much effort they expended on the given task on a seven-point Likert scale (where 1 denoted 'very little effort' and 7 denoted 'a great deal of effort'). The ANOVA results indicate that the accountants in the justification group expended more effort to complete the task (non-tabulated mean = 4.67) than the accountants in the control group (non-tabulated mean = 4.06, $F = 3.805$, $p = 0.056$). These results suggest that the manipulation of the justification requirement between the two groups was successful.

H2 is tested using one-way ANOVA where the justification requirement is the between-subject independent variable (justification requirement group/control group) with the accountant's revenue recognition decision serving as the dependent variable.

H2 predicts that the judgment justification requirement is likely to mitigate the confirmation bias arising from prior knowledge and beliefs about full IFRS when accountants interpret and apply IFRS for SMEs. The ANOVA results indicate that accountants in the justification group are significantly more likely to make a revenue classification decision that best reflects the economic substance of a transaction (mean = 4.03) than the accountants in the control group (mean = 5.42, F = 8.027, p = 0.006). The results in Table 3.4 provide support for H2.

3.4.2.3 Effect of decision aid in moderating the impact of confirmation bias in the reporting judgments of accountants (H3)

The respondents in the decision aid group were asked to indicate the extent to which the decision aid enabled them to make a better judgment on the given task on a seven-point Likert scale (where 1 denoted 'not at all' and 7 denoted 'to a great extent'). The mean response was 5.79, indicating that the decision aid assisted the accountants to make better judgments.

H3 is tested using one-way ANOVA where the decision aid provided is the between-subject independent variable (decision aid group/control group) with the accountant's revenue recognition decision serving as the dependent variable.

H3 predicts that the decision aid in the form of interpretation guidelines is likely to mitigate the confirmation bias arising from prior knowledge and beliefs about full IFRS when accountants interpret and apply IFRS for SMEs. The ANOVA results indicate that accountants in the decision aid group are significantly more likely to make revenue classification decisions that best reflect the economic substance of a transaction (mean = 3.07) than the control group (mean = 5.42, F = 18.620, p = 0.000). The results in Table 3.5 provide support for H3.

3.5 SUMMARY AND CONCLUSIONS

Most countries have moved towards adopting IFRS for SMEs in the belief that these stand-alone set of standards will improve the quality of their financial reporting for SMEs. This study provides novel evidence from a country that has adopted IFRS for SMEs on the effectiveness of this set of standard in guiding accounting choices. The study employs a behavioural experiment to investigate the effect of confirmation bias arising from prior knowledge and beliefs about full IFRS on the reporting judgments of accountants when applying IFRS for SMEs. This study therefore explores whether the mindset of accountants who preparer financial statement has shifted to accept IFRS for SMEs as a stand-alone set of standards.

The study finds support for the hypothesis that accountants who have a tendency to confirm prior knowledge and beliefs about full IFRS are unlikely to choose the accounting treatment that best reflects the economic substance of a transaction when applying IFRS for SMEs. Enhanced comparability and better quality financial reporting for SMEs have been promoted as the major benefits of adopting IFRS for SMEs. The ability of accountants to apply principles in IFRS for SMEs to specific accounting issues is crucial to achieving high quality reporting and consistent judgment outcomes. The results indicate that IFRS for SMEs will lead to improved financial reporting quality only when the financial statement preparer's mindset shifts and when all preparers apply IFRS for SMEs as a stand-alone set of standards i.e. independent of their prior knowledge and beliefs about full IFRS.

This study also finds evidence that the justification requirement and decision aids reduce the confirmation bias in the reporting judgments of accountants when applying IFRS for SMEs, which arises from prior knowledge and beliefs about full IFRS. The results suggest that inducing a form of justification requirement when accountants make reporting judgments for SMEs can eliminate the confirmation bias associated with prior knowledge and beliefs about full IFRS. Retaining justification records that provide evidence to support an accountant's judgment is desirable in a real world context. Reporting to superiors or outside authorities would also be a possible form of justification to preserve the accountability of the preparers of SME financial statements.

The role that decision aids play in mitigating confirmation bias in the reporting judgment of accountants when applying IFRS for SMEs provides novel evidence. The results indicate that by providing a decision aid in the form of an interpretation guideline that makes a clear distinction between the recognition and measurements principles of full IFRS and IFRS for SMEs can play an important role in enhancing the ability of accountants to choose the accounting treatment that best reflects the economic substance of a transaction when applying IFRS for SMEs. Such decision aids help to draw accountants away from their original frame of reference and encourage them to make more accurate and unbiased judgments, independent of their prior knowledge and beliefs about full IFRS. For financial statement preparers, the inability to recognise the differences in the recognition and measurement principles of full IFRS and IFRS for SMEs diminishes reporting accuracy. The results of this study will be of interest to accounting standard setters and regulatory bodies who wish to minimise the complications inherent in adopting two different versions of accounting standards in the same jurisdiction. An important implication from the findings is the need for policy makers in countries adopting IFRS for SMEs to invest in accounting education and training to improve accountants' knowledge and expertise, thus improving their ability to recognise the differences in the reporting requirements of full IFRS and IFRS for SMEs. Such an investment may overcome bias in the judgments of SME financial statement preparers and concerns regarding inter-firm comparability.

The IASB's objective of introducing IFRS for SMEs is centred on a new paradigm of enhancing decision usefulness and reducing the information asymmetry of the financial information provided by SMEs across the globe. The findings from this study have two important implications for the IASB in achieving these objectives. First, the introduction of more training materials and modules, working examples and training programs that articulate the differences between full IFRS and simplified IFRS for SMEs would be effective in guiding preparers through the standards and developing their knowledge, understanding and ability to make judgments in accordance with the requirements of IFRS for SMEs. Alternatively, the IASB could consider implementing reduced disclosures in IFRS for SMEs that are nevertheless consistent with the recognition and measurement principles of full IFRS, i.e. similar to the approach adopted in developed countries like Australia and New Zealand. The latter approach may also attract other developed countries and regions like European Union to adopt IFRS for SMEs.

It is noteworthy that the majority of the accountants indicated that there was confirmation bias in their reporting judgment when applying IFRS for SMEs. Clearly, the mindset of these accountants meant that they had not fully embraced the distinction between the principles of full IFRS and IFRS for SMEs. Such a result warrants further investigation to explore why financial statement preparers are still not willing to accept IFRS for SMEs as a stand-alone set of standards. Future studies could also examine why there are varying levels of confirmation bias among the preparers of financial statements and how this relates to the different cognitive strategies preparers may develop in the context of applying IFRS for SMEs. Such research would provide further insight into the role that confirmation bias arising from prior knowledge and beliefs on full IFRS plays in diminishing the quality of SME financial reporting practices.

It is important to note that the experiment focuses on a setting in which confirmation bias in the reporting judgment of accountants is examined across one decision context, i.e. recognition of revenues. To broaden the generalizability of the results, future studies could explore the confirmation bias in other contexts where the recognition and measurement requirements of IFRS for SMEs vary from those for full IFRS and their impact on the reporting decisions of financial statement preparers. Further research could also explore the interactive effects of confirmation bias and decision aids on the reporting judgments of accountants to substantiate the findings of this study. Alternative decision aids such as worked examples, for instance, might have a different impact on improving judgment and decision making, and could be usefully explored by future studies.

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Table 3.1: Demographic data of the respondents

Demographic Data	Control Group		Justification Group		Decision Aid Group	
Sample Size	33		30		29	
Gender	Male 13	Female 20	Male 17	Female 13	Male 19	Female 10
Age (Mean)	32		32		32	
Level of formal education in years (Mean)	17		17		17	
Level of professional experience in years (Mean)	5.36		6.23		4.77	
Level of familiarity with the Sri Lankan equivalents of full IFRS (Mean)	3.15		3.20		3.38	
Level of familiarity with the Sri Lankan equivalents of IFRS for SMEs (Mean)	2.67		2.97		2.69	
Frequency of using the Sri Lankan equivalents of full IFRS (Mean)	3.73		3.57		3.72	
Frequency of using the Sri Lankan equivalents of IFRS for SMEs (Mean)	2.94		3.17		3.07	

Table 3.2: Descriptive statistics and ANOVA results for confirmation bias in the reporting judgments of accountants

Prior Beliefs	Mean	Standard Deviation	F	p-value
Confirmation biased group n = 46	5.30	1.685	27.110	0.000***
Confirmation unbiased group n = 46	3.15	2.241		

***Significant at $p < 0.01$

Table 3.3: Binomial test of biased and unbiased judgments of accountants

Group	N	Observed Proportion	Test Proportion	p-value
Biased Judgment Group	59	0.64	0.50	0.009***
Unbiased Judgment Group	33	0.36		

***Significant at $p < 0.01$

Table 3.4: Descriptive statistics and ANOVA results for the effect of judgment justification on the reporting judgments of accountants

Group	Mean	Standard Deviation	F	p-value
Control Group n = 33	5.42	2.047	8.027	0.006***
Justification Group n = 30	4.03	1.829		

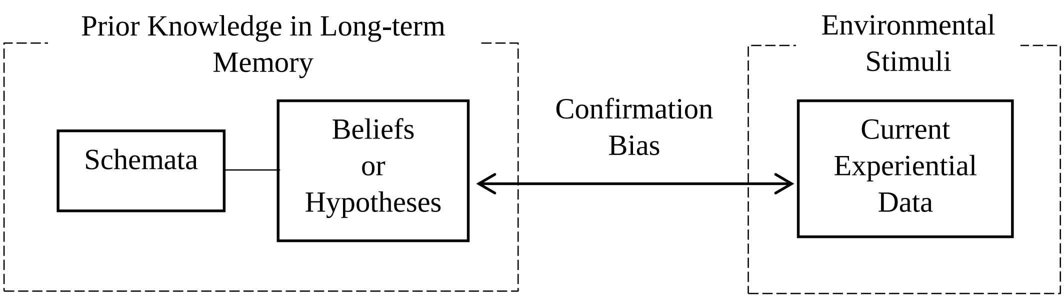
***Significant at $p < 0.01$

Table 3.5: Descriptive statistics and ANOVA results for the effect of decision aid on the reporting judgments of accountants

Group	Mean	Standard Deviation	F	p-value
Control Group n = 33	5.42	2.047	18.620	0.000***
Decision Aid Group n = 29	3.07	2.251		

***Significant at $p < 0.01$

Figure 3.1: Bias in knowledge retrieval process



Source: Waller & Felix (1984)

CHAPTER 4

(PAPER 3)

The Impact of the Reduced Guidance in International Financial Reporting Standards (IFRS) For Small and Medium-Sized Enterprises (SMEs) on the Reporting Judgments of Accountants

ABSTRACT

This study examines the effects of the reduced guidance in International Financial Reporting Standards (IFRS) for small and medium-sized enterprises (SMEs) on the reporting judgments of accountants. This study also examines the relative effectiveness of explicit guidance and the examples provided in accounting standards. The findings provide evidence that the ability of accountants to choose the accounting treatment that best reflects the economic substance of a transaction is diminished when limited guidance is available in IFRS for SMEs. The findings also show that accountants employ a biased reasoning approach when evaluating the examples by overstating the similarities presented in the examples. These findings will be of interest to the International Accounting Standards Board (IASB) as the IASB continues to monitor the implementation issues and the need for amendments to be made to IFRS for SMEs.

Keywords: IFRS, SMEs, reporting judgment, guidance, examples

4.0 INTRODUCTION

The International Accounting Standards Board (IASB) has pursued a strong agenda in recent years to develop a simplified set of International Financial Reporting Standards (IFRS) for small and medium-sized entities (SMEs). The IASB anticipates that the complexity and administrative burden of SME financial reporting will be eliminated by the simplification of IFRS for SMEs (IASB, 2009a, 2012). Compared to the detailed implementation guidance in full IFRS, there is significantly reduced guidance in IFRS for SMEs. For example, under derecognition of financial assets in Section 11 *Basic Financial Instruments* of IFRS for SMEs, no guidance is provided on the pass-through arrangements, continuing involvement and other relevant aspects of the transfer of a financial asset. Similarly, there is no detailed guidance on identifying the 'significant influence' in Section 14 *Investments in Associates* of IFRS for SMEs (IASC Foundation, 2010; PriceWaterhouseCoopers (PWC), 2009). Therefore, this study examines the effects of the reduced guidance in IFRS for SMEs on the reporting judgments of accountants and the potential bias towards the examples provided as guidance when accountants rely on these examples to determine the appropriate accounting treatment of accounting issues. This study also examines the relative effectiveness of explicit guidance and the examples provided as guidance on the reporting judgments of accountants.

The reduced guidance in IFRS for SMEs aims to relieve accountants from the interpretation complexities of accounting standards, but the reduced guidance in IFRS for SMEs has the potential to impair the communication accuracy of the standards, thus weakening reporting accuracy and consistency. It is argued that the elimination of the detailed implementation guidance in IFRS for SMEs may lower component complexity because it reduces the number of directions that accountants need to consider when they make reporting judgments. However, the absence of specific guidance in IFRS for SMEs could increase coordinative complexity, since accountants are required to follow a defined hierarchy (Nelson, 2003). In the absence of specific guidance on particular accounting issues, paragraph 10.4 of IFRS for SMEs requires management "to use its judgment in developing an accounting policy that is reliable and results in information that is relevant to the economic decision-making needs of users" (IASB, 2009a, p. 49). In deciding the appropriate accounting policy for an entity, paragraph 10.5 of IFRS for SMEs requires that the following hierarchy is adhered to:

a) the requirements and guidance in IFRS for SMEs dealing with similar and related issues; and
b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 *Concepts and Pervasive Principles*. (IASB, 2009a, p. 49)

In the absence of specific guidance, paragraph 10.6 of IFRS for SMEs allows management to consider the requirements and guidance in full IFRS that deal with similar and related issues in making judgments.

Critics contend that the latitude inherent in IFRS for SMEs may increase the discretion on allowable and disallowable accounting treatments (Ahmed, Neel, & Wang, 2013). In the absence of adequate guidance, some accountants may opt to follow the hierarchy, while others may comply with the guidance given in IFRS for SMEs. Therefore, this study argues that great variations in judgments will result when accountants interpret and apply IFRS for SMEs.

The successful communication of accurate financial information is an important objective of accounting standards. Nelson (2003) suggests that the communication accuracy of accounting standards can be enhanced by explicit directions on allowable and disallowable accounting treatments, or by proven examples and detailed implementation guidance. This view is debatable, however, due to the fact that voluminous accounting standards would increase the 'component complexity' of the judgment and decision making process as "the number of decisions to be made and the number of precedents and examples to be considered increase" (see Nelson, 2003, p. 94). On the other hand, less precise accounting standards would increase 'coordinative complexity', with the result that accountants would "combine information in complex or unspecified ways in determining whether a standard is satisfied" (see Nelson, 2003, p. 94). As such, accounting standard setters are confronted with a trade-off between these two scenarios.

Critics contend that the approach of allowing accountants to follow the hierarchy signifies the importance of guidance, even though this guidance has been removed from IFRS for SMEs to reduce the size of the booklet (ICAA, 2012). One of the major drivers of complexity in principles-based IFRS is the level of judgment needed to apply a standard, which requires the provision of implementation guidance (Benston, Bromwich, & Wagenhofer, 2006). The Singapore Accounting Standards Council (ASC) (2011, p. 2) points out that as the requirements and guidance in full IFRS may not always be consistent with those in IFRS for SMEs, applying full IFRS guidance could result in non-compliance with paragraph 10.5(a) of IFRS for SMEs, and hence the standard itself. As IFRS for SMEs are based on full IFRS (prior to any future amendments), the Hong Kong Institute of Certified Public Accountants (HKICPA, 2011) has raised concerns about the inconsistency created when a new standard is issued on the new principles rather than the old IFRS principles. This may hinder the consistency of application of the standard.

The application of the hierarchy is likely to be problematic for accountants in countries that have moved from local generally accepted accounting principles (GAAPs) to IFRS for SMEs. A lack of familiarity with IFRS, a lack of experience in applying an international set of financial reporting standards, and the potential knowledge shortfall (ICAEW, 2010) may make it difficult for those adopters to follow the above-mentioned hierarchy. In addition, inconsistency in judgments may result in poor quality financial information being produced by SMEs (Ahmed et al., 2013). These facts support the notion that the reduced guidance in IFRS for SMEs has become a challenging issue for those who have opted to adopt IFRS for SMEs.

IFRS for SMEs provide some guidance in the form of examples, but not in the form of explicit guidance.[28] For example, in determining the derecognition of financial assets, Section 11, *Basic Financial Instruments* does not provide explicit guidance on the transfer of risks and rewards of ownership of a financial asset. Instead, the standard provides examples of the transfer of a financial asset that may or may not qualify for derecognition. The International Accounting Standards Committee (IASC) Foundation (2010) has also issued training modules for users of IFRS for SMEs which contain extensive examples, self-assessment questions, and case studies that describe the accounting requirements of IFRS for SMEs.

[28] In the context of this study, ‘examples’ refer to hypothetical and precedent transactions included in the accounting standards and ‘explicit guidance’ refers to explanatory text in the accounting standards that clarifies the principles contained in the accounting standards (IASB, 2009a).

Prior research suggests that the absence of explicit guidance will have adverse consequences, as decision makers tend to over-rely on the treatments illustrated by examples and cases (Clor-Proell & Nelson, 2007).[29] Even if written instructions are provided, users are inclined to read the instructions superficially when other sources of information (such as examples) are available (LeFevre & Dixon, 1986).[30] There is also a potential risk of misinterpretation when examples are indiscriminately added to a set of instructions (LeFevre & Dixon, 1986). Clor-Proell and Nelson (2007, p. 702) advocate that "standard setters may want to consider the directional effect of example-based reasoning created by the combination of accounting standards and example type included in any implementation guidance that they provide, particularly if latitude in standards and implementation guidance increases with a shift towards a more principle-based regime". In the absence of explicit guidance in IFRS for SMEs, users of the standards may be overly dependent on the information in the examples, thus impairing the accuracy of their judgments.

Critiques on the reduced guidance in IFRS for SMEs are still limited to discussions and reviews (see ACCA, 2012; ICAA, 2012; HKICPA, 2011; KPMG, 2012) but no empirical studies have yet been conducted to examine the impact of the reduced guidance in IFRS for SMEs on the reporting judgments of accountants. It is imperative to empirically examine this issue, because inadequate guidance may impair judgment accuracy (Ahmed et al., 2013) and different types of guidance, such as the examples provided in the standard, may impair judgment consistency (Clor-Proell & Nelson, 2007).

To explore these issues, this study conducted an experiment in which experienced accountants were placed in a decision context of accounting for investments in associates. The availability of guidance was manipulated between participants who were either provided with limited explicit guidance in IFRS for SMEs or detailed explicit guidance in full IFRS for making their judgments. Example type was manipulated between participants

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[29] Even though there are many dissimilarities in the examples used in different domains, "examples" commonly share a fundamental purpose, namely, "to illustrate a principle or pattern" (Atkinson, Derry, Renkl, & Wortham, 2000, p. 182).

[30] The written instructions refer to rules, requirements or guidelines explicitly available to assist in problem solving and decision-making settings (LeFevre & Dixon, 1986).

where they were provided with either an affirmative example or a counter example as guidance in making their judgments.

The first hypothesis examines the effects of the reduced guidance in IFRS for SMEs on the reporting judgments of accountants. It is expected that there will be differences in the judgments of accountants who apply the reduced guidance in IFRS for SMEs and accountants who apply detailed guidance in full IFRS. As expected, accountants who refer to the reduced guidance in IFRS for SMEs are less likely to choose the accounting treatment that best reflects the economic substance of a transaction than accountants who refer to the detailed guidance in full IFRS. The findings generally support the notion that the reduced guidance in IFRS for SMEs is likely to impair the reporting judgments of accountants. The second hypothesis examines the likelihood that the examples provided as guidance bias the reporting judgments of accountants towards the similarities presented in the examples. The results reveal that accountants tend to overstate the similarities presented in the examples, thus biasing their judgments towards the treatment illustrated in the examples. The third hypothesis examines the relative effectiveness of explicit guidance versus examples. It is hypothesized that accountants receiving explicit guidance make more accurate judgments than accountants receiving examples as guidance. The results indicate that explicit guidance is not relatively more effective than examples when limited explicit guidance is available for making reporting judgments. Rather, explicit guidance is relatively more effective than examples only when detailed explicit guidance is available.

This study also proposes in the fourth hypothesis that accountants receiving a combination of examples and explicit guidance make more accurate judgments than accountants receiving either examples or explicit guidance alone. The results reveal that accountants receiving a combination of examples (affirmative and counter) and explicit guidance (IFRS for SMEs guidance and additional guidance in full IFRS) make significantly more accurate judgments than accountants receiving either IFRS for SMEs guidance or the examples alone.

This study contributes to the important debate on whether IFRS for SMEs have the potential to improve the quality of SME financial reporting. The findings suggest that the guidance provided in IFRS for SMEs is insufficient for making sound reporting judgments.

This study suggests that the IASB may need to reconsider the implementation of reduced disclosure in IFRS for SMEs and retain recognition and measurement principles and implementation guidance that are identical to full IFRS, i.e. similar to the approach adopted in developed countries like Australia and New Zealand. This approach may also encourage other developed countries to adopt IFRS for SMEs. Second, the IASB should be attentive when supplementing explicit guidance with examples. Therefore, the findings will be of interest to the IASB in shaping the optimal format for accounting standards, and IFRS for SMEs in particular.

The remainder of the paper is organized as follows. Section 4.1 provides the background of the study. Section 4.2 discusses the relevant theory and develops the hypotheses. Section 4.3 describes the experiment used to test the hypotheses. Section 4.4 presents the results and discussion. Section 4.5 provides a summary and offers the conclusions and implications of the study.

4.1 BACKGROUND

The controversy over the application of a tiered hierarchy approach in IFRS for SMEs has been widely discussed during the initial comprehensive review process of IFRS for SMEs, which was carried out by the IASB in 2012 (ACCA, 2012; KPMG, 2012). The issues associated with the fallback to full IFRS have gained increased attention, because aligning IFRS for SMEs in accordance with the periodic updates and amendments of full IFRS has become a challenging issue for the standard setters (IFRS Foundation, 2013a; ACCA, 2012; KPMG, 2012). For example, several changes have recently been made to the consolidation guidance in full IFRS by updating IFRS 10 *Consolidated Financial Statements*, which replaced International Accounting Standards (IAS) 27 *Consolidated and Separate Financial Statements.* IFRS 10 includes additional guidance on applying the control principle in a number of situations, which could be of significance for SMEs (ACCA, 2012).

Similarly, paragraph 11.33(b) in Section 11 *Basic Financial Instruments* of IFRS for SMEs, which concerns the derecognition of financial assets, does not provide adequate guidance for making judgments on the transfer of risks and rewards of ownership to another party (IASC Foundation, 2010). In such circumstances, the entity may refer to the guidance provided in paragraph 21 of the IAS 39 *Financial Instruments: Recognition and Measurement* of full IFRS.[31] In October 2010, the IASB transferred the requirements related to the derecognition of financial assets from IAS 39 to IFRS 9 *Financial Instruments* (IFRS Foundation, 2013a). However, SMEs are not permitted to apply IFRS 9 (IFRS Foundation, 2012c, 2013a).[32]

Emphasis has been placed on the necessity for concurrent amendments to IFRS for SMEs to avoid inconsistency in accounting requirements between full IFRS and IFRS for SMEs (ACCA, 2012; New Zealand Accounting Standards Board, 2012). The IASB issued proposed amendments to IFRS for SMEs in May 2015, which consist of a limited number of amendments to the accounting requirements, clarification of the existing requirements and supporting guidance; however, no amendments have been proposed that will align the amendments in full IFRS with IFRS for SMEs (IFRS Foundation, 2015a). Thus, the gap in accounting requirements between full IFRS and IFRS for SMEs is becoming wider. This divergence may create difficulties in interpretation and inconsistency in reporting judgments when accountants refer to full IFRS for additional guidance (ACCA, 2012).

The objective of preparing high quality financial information by SMEs will not be achieved if accountants do not follow the hierarchy appropriately. Due to the lack of guidance, the interpretation and implementation of IFRS for SMEs require significant IFRS expertise in some instances. For an example, additional expert consultation may be required to carry out comprehensive actuarial valuations in Section 28 *Employee Benefits* (ICAA, 2012; KPMG, 2010). This may indicate that in practice, it is challenging to accept the simplified IFRS for SMEs as a stand-alone set of standards, because this action may not simplify the workload of accountants (ICAA, 2012).

[31] IFRS for SMEs currently permit entities to choose to apply the recognition and measurement provisions of IAS 39, and this is the only time that IFRS for SMEs permit the use of full IFRS.

[32] The Basis for the Conclusions of IFRS for SMEs (in Section 11 Q&A paragraph BC1) notes that "allowing the use of IFRS 9 by SMEs would require a change to IFRS for SMEs" (IFRS Foundation, 2012c, p. 2). After completing a comprehensive review process of IFRS for SMEs in 2014, the IASB decided to post the latest version of IAS 39, not updated by IFRS 9 Financial Instruments, to the SME project pages of the IASB website, with the updated version of IFRS for SMEs referring to this location (IFRS Foundation, 2014b).

The Securities Exchange Commission (SEC) (2003) indicates that the principles-only standards may present enforcement difficulties because they provide little guidance or structure for preparers and auditors to exercise professional judgments. More guidance has therefore been added in the recently-issued IFRS. As an example, IFRS 10 *Consolidated Financial Statements* contains new detailed guidance on the principle of ‘control’. It has also been suggested that IFRS Interpretation Committee (IFRIC) should include further guidance in IFRS 2 *Share-Based Payments* to describe how vesting and non-vesting conditions have different impacts on the measurement of liability (Deloitte Touch Tohmatsu, 2014).[33] Prior studies that examine the effects of guidance on the reporting judgments of accountants also substantiate the importance of providing adequate guidance in principles-based IFRS (see Gill, 2002; Mala & Chand, 2014 for a review). These findings establish the significance of examining the impact of the reduced guidance in IFRS for SMEs on the reporting judgments of accountants.

Although theoretical discussions exist, there is no empirical evidence to substantiate the perception that the reduced guidance in IFRS for SMEs will have adverse consequences for the reporting judgments of accountants. Further, our understanding of accountants’ use of guidance (particularly examples as guidance) for exercising reporting judgments remains limited. This study is important because national regulators in many emerging economies have opted for reporting under IFRS for SMEs (IFRS Foundation, 2012a) but are experiencing many challenges in light of the difficulties associated with the implementation of an international set of standards. The lack of professional competency in particular is considered to be challenging for the successful implementation of the accounting requirements for SMEs (Albu, Albu, Bunea, Calu, & Girbina, 2011; ICAA, 2012). Understanding the judgment and decision making behaviour of accountants in the context of IFRS for SMEs is important, as the IASB is continuing to monitor the implementation of IFRS for SMEs. The findings of this study may help accounting regulators to determine suitable ways of minimizing the potentially undesirable outcomes associated with the simplified IFRS for SMEs.

[33] Additionally, the committee has proposed the addition of more examples on cash-settled share-based payment transactions (Deloitte Touch Tohmatsu, 2014).

4.2 THEORY AND HYPOTHESES DEVELOPMENT

4.2.1 Effects of availability of guidance on the judgments of decision makers

Libby and Luft (1993) refer to guidance and support as the 'technology'—the environment in which various guidance and technological aid is provided to assist a decision maker to make their judgments. In an accounting setting, the technical elements in the accounting standards, such as the accounting principles and the guidelines, have the ability to influence judgment performance by changing the task requirements and motivation to perform the task (see Libby & Luft, 1993 for a similar finding in the audit environment).[34] The availability of different forms of guidance increases the motivation to perform the task by reducing the effort that a decision maker must expend to complete the task. Thus, when the availability of guidance in the accounting environment varies, the judgment performance of accountants is influenced by such variations (Libby & Luft, 1993; McDaniel, 1990). Guidance is therefore considered to be an important element in judgment and decision making in the accounting context that should not be disregarded (Ahmed et al., 2013; Messier Jr, Quick, & Vandervelde, 2014; Schipper, 2005).

This study draws upon relevant literature in auditing and accounting contexts which examines the impact of the availability of guidance on the judgment performance of accountants in principles-based and rules-based accounting standards contexts. A limited amount of audit research has investigated auditors' decision-making behaviour under the guidance provided in principles-based standards. Quick (2013) notes that the guidance provided in principles-based standards allows auditors to make decisions that reflect the economic substance of a transaction, in contrast to the bright-line thresholds in rules-based standards.

Peytcheva and Wright (2010) and Peytcheva, Wright, and Majoor (2014) provide evidence that auditors experience greater epistemic motivation under guidance provided in

[34] Libby and Luft (1993) note that task requirements are associated with the knowledge, ability and effort the decision maker must bring to the task to achieve a given level of performance, whereas motivation is associated with the amount of effort that decision makers are willing to employ to fulfil the requirements.

principles-based accounting standards than rules-based accounting standards.[35] Peytcheva et al. (2014) conducted an experiment in the audit evidence context to investigate the effect of rules-based versus principles-based accounting guidance on auditors' epistemic motivation and demand for audit evidence. The subjects in their experiment were exposed to a classification of lease transaction which required them to examine and select additional evidence. The availability of guidance was manipulated between groups by the provision of specific criteria for lease classification under principles-based and rules-based standards. The authors' findings provide evidence that guidance in principles-based standards influences auditors' cognitive motivation by increasing process accountability and epistemic motivation. The authors conclude that the principles-based environment stimulates the perception of being accountable, which serves to maintain the quality of the process in reaching decisions. They further note that the principles-based environment stimulates epistemic motivation—the willingness of auditors to gain a thorough understanding of the problem at hand.

Studies in the audit context also document that the lack of authoritative guidance has adverse consequences for audit decision-making (Ng & Tan, 2003; Salterio, 1996; Salterio & Koonce, 1997). For example, Salterio and Koonce (1997, p. 574) note that auditors are often confronted by an accounting problem for which authoritative standards are not available or do not provide clear guidance. Ng and Tan (2003) provide evidence that the availability of authoritative guidance influences auditors' perceptions of negotiation outcomes, especially in the absence of an effective audit committee. Their findings suggest that auditors will allow aggressive accounting by the client in the absence of authoritative guidance, and when the client's audit committee is weak.

Prior studies also show that the latitude inherent in principles-based accounting standards and the imprecise nature of the guidance contained in the standards may lead to aggressive financial reporting (Cuccia, Hackenbrack, & Nelson, 1995; Hackenbrack & Nelson, 1996). For example, Hackenbrack and Nelson (1996) note that when latitude exists as a result of the vague language used in the professional standards, auditors tend to validate their aggressive reporting by applying the professional standards aggressively. However, Cuccia

[35] De Dreu, Beersma, Stroebe, and Euwema (2006, p. 298) define epistemic motivation as the desire to develop and maintain a rich and accurate understanding of the world.

et al. (1995) indicate that changing to more precise standards is not an effective approach to diminishing aggressive reporting decisions when there is an incentive to report aggressively. Ahmed et al. (2013, p. 1348) note that for some important areas, such as revenue recognition for multiple deliverables, the absence of implementation guidance significantly increases discretion and allowable treatments depending upon how standards are interpreted and implemented. This increase in discretion due to the lack of implementation guidance is likely to encourage earnings management, thus lowering the quality of the accounting.

While many of the research studies on the effects of the availability of guidance have been undertaken in the audit judgment and decision making context, only a few researchers in the accounting domain have explored the effects of the availability of guidance on the judgment performance of accountants. A study carried out in IFRS context documents that the provision of additional guidance in IFRS assists in the reduction of interpretation complexity and enhances the accuracy of judgments made by accountants (Mala & Chand, 2014). Mala and Chand (2014) conducted an experiment to examine whether additional guidance provided in IFRS affects the accuracy of judgments made by accountants. In their experiment, the effect of additional guidance was manipulated between subjects. The subjects in one group were given relevant paragraphs from IAS 17 *Leases* and the subjects in the other group were given additional guidance. All subjects were required to exercise judgment on whether a leased item indicated in the scenario should be recognized as an operating lease or a finance lease. Mala and Chand's (2014) findings provide evidence that accountants who are equipped with additional guidance make more accurate judgments than accountants who do not receive additional guidance. The authors suggest that additional guidance as a decision aid tool enhances judgment accuracy of accountants. Their findings further support the notion that additional guidance is more supportive when the perceived complexity of the task is high.

In assessing the complexities of the principles-based IFRS context, researchers have extensively advocated the importance of providing the detailed and additional guidance necessary to explain the principles contained in the accounting standards and put them into practice (see Gill, 2002; Mala & Chand, 2014; Schipper, 2005). Schipper (2005) reports that as business transactions gradually become more sophisticated, the need for detailed implementation guidance for the application of IFRS may increase over time. Preparers' reliance on other sources of information could also increase in the absence of detailed guidance, resulting in a loss of comparability in financial information (Benston et al., 2006; Gill, 2002).

Generally, prior research that has examined the effects of the availability of guidance on the judgment performance of decision makers shows that the availability of guidance positively influences the judgment performance of individuals. The motivation for these prior studies has been driven by the increasing use of judgments in principles-based IFRS. While the findings from the full IFRS context advocate that guidance must be adequately provided in the principles-based IFRS context, more empirical evidence is required in the context of IFRS for SMEs to determine whether, in the absence of guidance in IFRS for SMEs, allowing accountants to follow a tiered hierarchy will preserve the accuracy and consistency of the judgments of accountants. In contrast to the prior studies, therefore, the arguments in this study focus on the issues that may arise when accountants follow the hierarchy in deciding appropriate accounting policy and treatment.

4.2.2 Effects of the reduced guidance in IFRS for SMEs on the reporting judgments of accountants (H1)

In the IFRS for SMEs setting, the elimination of the detailed implementation guidance in IFRS for SMEs possibly lowers component complexity because it reduces the number of directions that accountants need to consider when making reporting judgments (Nelson, 2003). On the other hand, it can also be argued that the absence of specific guidance in IFRS for SMEs possibly increases coordinative complexity, since accountants are required to follow a hierarchy in deciding the appropriate accounting policy and treatment (IASB, 2009a). Accountants will be required to combine the information in a sophisticated way to ensure compliance with requirements of the standard (Nelson, 2003). It is possible that some accountants may opt to follow the hierarchy, while others may comply with the guidance provided in IFRS for SMEs. Thus, the absence of detailed guidance may increase discretion on allowable and disallowable accounting treatments, depending on how the standard is interpreted and implemented (Ahmed et al., 2013). It is suggested that the additional guidance reduces those interpretation complexities and enhances the reporting accuracy in principles-based accounting (Mala & Chand, 2014; Nelson, 2003). Therefore, this study anticipates that there will be differences in judgments when accountants are provided with IFRS for SMEs guidance rather than full IFRS guidance.

To examine the impact of the reduced guidance in IFRS for SMEs on the reporting judgments of accountants, this study selects the accounting for investments in associates decision context, for which the explicit guidance of IFRS for SMEs has been significantly reduced. Section 14 *Investments in Associates* of IFRS for SMEs defines significant influence as "…the power to participate in the financial and operating policy decisions of the associate…" (IASB, 2009a, p. 81).

The standard states that significant influence would be presumed if an investor holds 20 percent or more of the voting power of the investee. This presumption is rebuttable because if the investor can demonstrate that such influence does not exist, the investee is not classified as an associate. However, in instances where it is unclear whether significant influence exists, judgment must be exercised to determine its existence, for which more guidance may be required (IASC Foundation, 2010). For example, if it can be clearly demonstrated that an investor holding less than 20 percent of the voting power of the investee exercises significant influence, the investment will be accounted for as an associate. The IAS 28 *Investments in Associates and Joint Venture* of full IFRS provides an additional list of factors that may indicate the existence of significant influence over an investee; however, this explicit guidance is not included in Section 14 of IFRS for SMEs. In such a setting, this study expects that accountants will be unlikely to choose the accounting treatment that best reflects the economic substance of a transaction when applying the reduced guidance in IFRS for SMEs. This study assumes that the additional guidance provided in full IFRS will assist accountants to determine the existence of significant influence more accurately than accountants who refer to the limited guidance in IFRS for SMEs. Accordingly, the following hypothesis is formulated:

H1: There will be differences in judgments between accountants who are provided with the reduced guidance in IFRS for SMEs and accountants who are provided with detailed guidance in full IFRS.

4.2.3 Effects of examples provided as guidance on the judgments of decision makers

Examples are generally considered to be abstracts that are not intended to communicate decision thresholds (Clor-Proell & Nelson, 2007). However, well-designed examples play a vital role in clarifying or supplementing the instructions (LeFevre & Dixon, 1986). In the accounting context, examples are considered to describe hypothetical transactions and scenarios for the purpose of providing the guidance that is necessary to explain and operationalize the principles contained in accounting standards (IASB, 2009a). Therefore, examples accompanied by the accounting standards are considered to be important guidance elements that have the ability to influence judgments.

Prior research in various domains has investigated different aspects of the use of examples in problem solving and decision-making tasks. Researchers have been interested in examining how examples help to improve task performance, and have documented that examples are considered to be an important source that assists in the accurate understanding and performance of tasks. Wynder and Luckett (1999) show that worked examples increase task performance by providing task-specific heuristics. Halabi, Tuovinen, and Farley (2005) find that compared to problem-solving exercises (which contain only instructions), worked examples ease the learning process by reducing the cognitive effort that is required to complete the task. Generally, research suggests that worked examples have the ability to enhance the judgment performance of a decision maker on similar tasks (Cooper & Sweller, 1987; LeFevre & Dixon, 1986).

This study explores an important aspect of the use of examples—the reliance of decision makers on the examples. Prior research examining similarity in judgments (Marchant, 1989; Salterio, 1996; Tversky, 1977) and example-based reasoning (Clor-Proell & Nelson, 2007) maintains that accountants rely heavily on treatments illustrated by the examples and cases, and consider them to be more appropriate to their situation, rather than validating the underlying facts of their actual situation. In the audit context, researchers have examined the effects of content and the perceived similarity of precedents on auditors' accounting policy judgments, and have concluded that auditors rely heavily on precedents which are perceived to be similar to their situation (Salterio, 1996; Salterio & Koonce, 1997).[36] For example, Salterio and Koonce (1997) examined auditors' responses to precedents in accounting situations in the absence of guidance on the appropriate accounting treatment of a financial transaction. The authors note that auditors must consider possible alternative accounting treatments, such as the relevant precedents, when authoritative guidance is not available or when the accounting standards do not provide clear guidance. They developed their hypotheses based on the notion that the more similar the facts in the precedents are to those in the problem situation, the more favorably those precedents are perceived. The findings of their experiments show that in the absence of authoritative guidance, auditors use the content of available precedents when making judgments on appropriate accounting treatments. Importantly, their findings show that auditors rely more on precedents that are similar to the problem situation rather than precedents that are dissimilar to the problem situation when they make judgments on the appropriate accounting treatment of a financial transaction.

Findings from prior research in accounting also suggest that in the absence of explicit guidance, the directional effect of examples (provided as guidance) biases the judgments made by the accountants. For example, Clor-Proell and Nelson (2007) provide evidence on how 'examples' as guidance that accompanies accounting standards can result in either aggressive or conservative application of the standards. Based on a psychological phenomenon, they hypothesized that accountants provided with affirmative (counter) examples are more (less) likely to conclude that an accounting treatment is appropriate.[37] Using two case conditions (revenue/expenses) and two example conditions (affirmative/counter), the judgments made by accountants on the appropriateness of income-statement recognition were tested. The findings provide evidence that the probability of income-statement recognition by accountants is higher when accountants are provided with affirmative examples than when they are provided with counter examples. The findings further indicate that when participants are provided with both affirmative and counter examples, they respond as if they had only received affirmative examples.

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[36] Salterio (1996) defines 'precedents' in auditing as "prior examples of similar situations encountered in the firm's practice documented in internal memorandum or by other audit firms as seen in the published financial statements disclosures" (p. 467).

[37] Clor-Proell and Nelson (2007) developed this argument based on two psychological perspectives. First, they claimed that there is high likelihood of overstating the similarity of features between the example and the target case (which they referred to as *similarity assessment*). Second, they claimed that the evaluative tone of the outcome specified by the example, (for example, recognition is allowable rather than not allowable) stimulates the income-increasing behaviour of practitioners (which they referred to as *priming*).

The general conclusion derived from much of the prior research is that the elements contained in examples bias the judgments and decisions of an individual. Further, they restrain learners from acquiring knowledge and exerting more cognitive effort on decision-making tasks.

4.2.4 Effects of examples provided in IFRS for SMEs as guidance on the reporting judgments of accountants (H2)

The purpose of this study is to better understand how well accountants make judgments based on the examples provided as guidance for situations for which explicit guidance in IFRS for SMEs does not exist. When designing IFRS for SMEs, standard setters have attempted to clarify some of the principles contained in the standards using examples rather than explicit guidance. However, these examples may not adequately communicate explanations that are explicitly available as guidance in full IFRS.

Section 11 *Basic Financial Instruments* in IFRS for SMEs, for example, does not provide explicit guidance on how to make judgments on the derecognition of financial assets to determine whether an entity has transferred substantially all of the risks and rewards of ownership to another party. Instead, the standard is accompanied by two examples: a transfer of financial asset that qualifies for derecognition, and a transfer that does not qualify for derecognition. The risks and rewards assessment conditions given in the examples may communicate to preparers that those are the key criteria that entities should consider when evaluating whether substantially all of the risks and rewards of ownership of the financial asset have been transferred. However, in some complex cases where the terms and conditions of the transfer are not clear, the evaluation of risks and rewards is based on the entity's exposure before and after the transfer to the variability in the amounts and timing of net cash flows (IFRS Foundation, 2010). Neither explicit guidance nor examples for such instances are provided in Section 11 of IFRS for SMEs; however, IAS 39 *Financial Instruments: Recognition and Measurement* of full IFRS provides explicit guidance that is relevant for making judgments in such circumstances.

In an actual accounting environment, it is very rare for the hypothetical transactions prescribed in the examples to coincide perfectly with real accounting problems. Therefore, when examples do not cover the transactions in question, or when there is a lack of clarity in the examples, it is possible that accountants will make inappropriate judgments if they are over-dependent on the similarities presented in the examples. This effect is expected to occur because decision makers presume that the similarities evident in examples or precedents are appropriate to their cases (Clor-Proell & Nelson, 2007; Salterio & Koonce, 1997). As noted by Marchant, Robinson, Anderson, and Schadewald (1993), when precedents are applied in problem solving tasks, it is important to pay attention to (1) the similarities and dissimilarities of the precedents to the problem situation, and (2) the outcome indicated by the precedent.

This study draws on literature from similarity judgments in psychology to establish the argument of this study.[38] Tversky (1977, p. 327) describes similarity as "a feature-matching process".[39] A contrast model developed by Tversky (1977) notes that the similarity of objects is expressed as a linear combination, or a contrast of the measures of their common and distinctive features. When a similarity assessment task is given, subjects tend to pay more attention to the common (i.e., shared) features. In contrast, when a dissimilarity assessment task is given, subjects tend to be more attentive to the distinctive features. Findings from prior research provide further evidence that when the similarity of the details presented in the precedent to those in the actual problem situation is strong, decision makers tend to overstate the similarities presented (Marchant, 1989; Salterio & Koonce, 1997). Prior research also suggests that the directional effects of the example types provided as guidance in accounting standards will influence the judgments made by accountants (Clor-Proell & Nelson, 2007).[40]

In line with the findings of prior research, it is argued that the similarities in details provided in examples will have a negative influence on judgments if accountants tend to

[38] Tversky (1977) views similarity judgments as extensions of similarity statements, that is, statements of the form "a is like b". Such a statement is directional; it has a subject, a, and a referent, b, and is not equivalent in general to the converse similarity statement "b is like a". In fact, the choice of subject and referent depends, at least in part, on the relative salience of the objects (p. 328).

[39] Tversky (1977) notes that feature matching model can be applied to analyse empirical phenomena such as "…the role of common and distinctive features, the relations between judgments of similarity and difference, the presence of asymmetric similarities, and the effects of context on similarities" (p. 329).

[40] Clor-Proell and Nelson (2007) refer to examples that provide guidance on acceptable reporting as "affirmative examples" and examples that provide guidance on unacceptable reporting as "counter examples".

overstate the similarities (Marchant, 1989; Salterio & Koonce, 1997; Tversky, 1977). In an accounting setting, attention should also be paid to examples accompanying the accounting standards that indicate the outcome of a hypothetical transaction. Based on the notion that the directional effects (outcome) of examples influence the judgments made by accountants, this study argues that the bias towards the similarities presented in examples varies according to the directional effects of the outcome indicated by the examples (affirmative and counter examples).

To examine this effect in the context of IFRS for SMEs, this study selects the same decision context applied for testing H1, the accounting for investments in associates decision context. This study argues that providing examples that illustrate the existence/non-existence of significant influence under different circumstances will offer an avenue for accountants to analyse whether thresholds inferred by examples are consistent/inconsistent with their situation. Accordingly, this study considers an example that provides guidance on the existence of significant influence as an ‘affirmative’ example, whereas an example that provides guidance on the non-existence of significant influence is a ‘counter’ example. A respondent who receives an example (affirmative/counter) which describes the existence/non-existence of significant influence may conclude that significant influence exists/does not exist in the target case if he/she finds a similarity between the threshold inferred by the example and the target case, even if the target case contains contradictory information. Consequently, it is expected that judgments made by accountants will be biased towards the similarities presented in examples, if they tend to over-rely on these similarities. Accordingly, the following hypothesis is formulated:

H2: It is likely that the examples provided as guidance will bias the professional judgments of accountants towards the similarities presented in the examples.

4.2.5 Effects of explicit guidance versus examples in IFRS for SMEs on the reporting judgments of accountants (H3)

Based on the literature reviewed in the previous section, a prediction was made that accountants' reliance on examples will have a negative influence if accountants tend to over-rely on the similarities presented in the examples. The limited number of studies that have investigated the accountants' use of examples as guidance note that the judgments of accountants are biased towards the similarities presented in the examples (Clor-Proell & Nelson, 2007). Furthermore, the few prior studies in the accounting context document that the provision of additional guidance in IFRS reduces interpretation complexity and enhances judgment accuracy (Mala & Chand, 2014). However, we lack an understanding of the relative effectiveness of explicit guidance versus examples on judgment accuracy. Therefore, this study examines the relative effectiveness of the two forms of guidance—explicit guidance and examples¸ on the reporting judgments of accountants.

A small number of prior studies in different domains have attempted to investigate the relative effectiveness of worked examples and instructions in decision-making contexts. Wynder and Luckett (1999) conducted a study to demonstrate the effects of worked examples and understanding-rules on the knowledge acquisition and task performance of accountants.[41] As the authors showed, worked examples and instructions on how to understand rules improve the task performance of accountants equally well. However, as noted by the authors, these two forms of guidance are performed in different ways. Understanding-rules instructions increase task performance through the acquisition of procedural knowledge [i.e. "…understanding the appropriate procedures associated with the task" (p. 178)], whereas, worked examples increase task performance through the acquisition of task-specific knowledge. Importantly, these findings suggest that worked examples can only be beneficial when decision makers perform specific tasks similar to the tasks demonstrated by the worked examples. Consistent with this view, Anderson, Farrell and Sauers (1984) note that examples that demonstrate similarities to the task

[41] Wynder and Luckett (1999) extended the study by Bonner and Walker (1994) that investigated the effects of alternative forms of instructions (how-to-rules and understanding-rules) and experience on the acquisition of procedural knowledge and the judgment performance of auditors. Bonner and Walker (1994) define *how-to-rules* as instructions that consist of "lists of steps or procedures to be followed in performing a task" (p. 159), and *understanding-rules* as instructions that provide "explanations with the steps, and possibly, information about why the steps are performed, how they relate to each other…" (p. 159).

provide more useful information for constructing a procedure than written instructions. LeFevre and Dixon (1986) also report that examples are considered to be similar in appearance to the target problem and therefore more compelling than written instructions.

LeFevre and Dixon (1986) used several experiments to compare the relative effectiveness of written instructions and examples on an inductive reasoning task. The information contained in these two sources of information was mutually contradictory. The authors found strong evidence that subjects rely more heavily on examples than written instructions in making their decisions. Subjects process the written instructions superficially when they are also provided with examples, and they make conclusions in accordance with the examples immediately after evaluating the examples (even if they are provided with written instructions). LeFevre and Dixon (1986) further note that there is a higher possibility of misinterpreting the examples than the written instructions.

Based on the arguments presented in this study, the examples will have a negative influence on the accuracy of reporting judgments if accountants tend to rely too heavily on the similarities presented in examples (H2). Consistent with the findings of prior studies, this study also expects that explicit guidance will have a more positive influence on judgment accuracy than examples. In the decision context of accounting for investments in associates, it is expected that a respondent who receives an example (affirmative/counter) which describes the existence/non-existence of significant influence may conclude that the significant influence exists/does not exist in the target case if he/she finds a similarity between the threshold inferred by the example and the target case, even if the target case contains contradictory information. It is also expected that this bias will not exist when respondents are provided with explicit guidance (IFRS for SMEs/full IFRS guidance), indicating that explicit guidance is more influential on making sound judgments than examples. Accordingly, the following hypothesis is formulated:

H3: Accountants receiving explicit guidance will make more accurate judgments than accountants receiving examples as guidance.

4.2.6 Effects of explicit guidance and examples in IFRS for SMEs on the reporting judgments of accountants (H4)

This study investigates the likelihood that accountants make more accurate judgments when they are provided with both examples and explicit guidance than when they are provided with either examples or explicit guidance alone. Prior research documents that the task performance of an individual can be maximized by combining worked examples with understanding-rules (Wynder & Luckett, 1999). As discussed previously, understanding-rules improve task performance through the acquisition of procedural knowledge. Even though procedural knowledge cannot be acquired by worked examples, it helps to improve task performance by providing task specific heuristics (Wynder & Luckett, 1999). Research suggests that a combination of task-specific heuristics and procedural knowledge develops the highest levels of task performance of an individual. This is because a worked example diverts a decision maker's attention from the information provided by the understanding-rules. Thus, a combination of worked examples and understanding-rules improves the task performance of an individual.

This study expects that if an accountant fails to extract the idea prescribed by the explicit guidance, examples will be useful in explaining and operationalizing the idea prescribed by the explicit guidance. On the other hand, explicit guidance will draw accountants' attention to the similarities with the target case presented in the examples. It is further assumed that bias towards similarities presented in examples and the directional effects of the outcomes indicated by the examples can be avoided when accountants are provided with an equal mix of both affirmative and counter examples (Clor-Proell & Nelson, 2007). That is, there will be a counterbalance between the similarities in an affirmative example with the target case and the similarities in a counter example with the target case, such that the bias towards the similarities presented in examples can be avoided.

In the decision context of accounting for investments in associates, this study expects that a combination of guidance in IFRS for SMEs, additional guidance in full IFRS and the examples (Affirmative and Counter) will be more influential in making accurate judgments than if they are presented independently. Accordingly, the following hypothesis is formulated:

H4: Accountants receiving a combination of examples and explicit guidance will make more accurate judgments than those receiving either examples or explicit guidance alone.

4.3 EXPERIMENT

4.3.1 Participants and design

For the purpose of this study, it was determined that the research setting should represent a country that has adopted IFRS for SMEs. Fiji has taken the lead in adopting IFRS for SMEs in the Asia-Pacific region, and shortly after the standard was issued in 2009, all entities not identified as 'listed entities' were required to comply with IFRS for SMEs for the reporting period beginning on or after 1st January 2011. The new Fijian equivalents of IFRS for SMEs is a completely stand-alone set of standards. The financial reporting setting in Fiji provides an appropriate research setting for the current study.

The participants in the experiment of this study were 148 qualified accountants of the Fiji Institute of Accountants with an average of 5.07 years of work experience in financial reporting. The respondents had relevant education, training and experience in dealing with both the Fijian equivalents of full IFRS and IFRS for SMEs. Because the experiment asks participants to choose the accounting treatment that best reflects the underlying economics of transactions for an SME faced with accounting for investments in associates decisions, it was important to select Fijian-based accountants who had experience in making financial reporting decisions in the context of IFRS for SMEs.

The experiment took place in a professional workshop of the Fiji Institute of Accountants. The participants were randomly assigned to one of the five groups, with 28 participants in IFRS for SMEs guidance group, 29 participants in full IFRS guidance group, 31 participants in the affirmative example group, 29 participants in the counter example group and 31 participants in the all guidance (explicit guidance and examples) group.

To test the hypotheses, this study conducted the experiment that required participants to make a decision on accounting for investments in associates for an SME. This study selected the decision context of accounting for investments in associates to assess whether or not significant influence exists over another entity, since the guidance in IFRS for SMEs is significantly reduced compared to the detailed guidance provided in full IFRS.

The availability of guidance was manipulated between participants, who were either provided with IFRS for SMEs guidance or full IFRS guidance. The example types were manipulated between participants, who were either provided with an affirmative example or a counter example as guidance for making their judgments.

To preserve internal validity and to enable differences in the reporting judgments of accountants to be attributable to the two variables of interest (availability of guidance and example types), particular care was taken in designing the scenario. Potentially confounding variables that could affect the reporting judgments of accountants were controlled. In the context of this study, no incentives were provided to the accountants to influence their reporting judgments. For the given scenario, participants were simply instructed to choose the accounting treatment that best reflected the underlying economics of transaction for an SME faced with an accounting for investments in associates decision.

4.3.2 Procedures

This study provided the participants with a research instrument comprising two sections (Appendix 3). The first section required respondents to provide demographic data such as gender, age, level of formal education, employer details and years of work experience. The respondents were also asked to indicate their level of familiarity with the Fijian equivalents of full IFRS and IFRS for SMEs (measured both by how familiar they were with full IFRS/IFRS for SMEs and how frequently they referred to these standards in their professional practice).

The second section contained the case scenario. A practical scenario was developed in which participants had to make a reporting judgment on behalf of the SME. The scenario was based on accounting for investments in associates. The scenario provided key facts relating to the transaction in question. These facts were designed in line with Section 14 of IFRS for SMEs [paragraphs 14.3 (a, b and c) – Significant Influence], and the IAS 28 (paragraphs 6-9) in determining the existence of significant influence over an investee.

The hypothetical company is a medium-sized non-listed company which engages in the wholesale of automotive spare parts to a range of independent retailers. The company acquires an 18 percent stake (directly and through a subsidiary) in a retail chain in the automotive spare parts market. The company represents two members of the Board of Directors of the investee; however, the company's Board representation is not available for most of the Board meetings of the investee. There exist some material transactions between the company and the investee during the financial year. Additionally, the company offers strong marketing support and a wide range of retail services to its independent retailer network, including the investee, by providing advice and coaching on marketing strategy to ensure customer satisfaction. The participants were asked to make their reporting judgments on behalf of the company as to whether to account for the investment as an associate.

As the availability of the guidance (IFRS for SMEs guidance and full IFRS guidance) and example types (affirmative and counter examples) for making reporting judgments were manipulated between participants, five versions of the instrument were prepared.

4.3.3 Manipulation of guidance

The first two versions of the instrument were prepared to vary the implications of the availability of guidance on the respondents' reporting judgments. In the first version, the participants were provided with the relevant paragraphs of Section 14 of IFRS for SMEs [paragraphs 14.3 (a, b and c) – Significant Influence], while in the second version, the participants were provided with additional guidance in IAS 28 (paragraphs 6-9) of full IFRS to determine the existence of significant influence over an investee.

The additional guidance in IAS 28 provides indicators of the existence of significant influence by an investor.[42] Based on the substance of the relationship in each case, if it can be clearly demonstrated that an investor holding less than 20 percent of the voting power

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[42] The existence of significant influence by an entity is usually evidenced in one or more of the following ways: a) representation on the board of directors or equivalent governing body of the investee; b) participation in policy-making processes, including participation in decisions about dividends or other distributions; c) material transactions between the entity and its investee; d) interchange of managerial personnel; or e) provision of essential technical information (IFRS Foundation, 2001b, p. A931).

of the investee exercises significant influence, the investment will be accounted for as an associate. Because the company holds 18 percent of the voting power of the investee, judgment must be exercised after considering all the facts and circumstances, as indicated by the additional guidance. The participants were asked to record their judgment that the investee could be treated as an associate of the company on a seven-point Likert scale where 1 denoted ‘strongly disagree’ and 7 denoted ‘strongly agree’.

The manipulation check for the availability of guidance was conducted post-experiment when participants were asked to indicate the level of help provided by the guidance in making their judgment by circling the rating choice on a seven-point Likert scale (where 1 denoted ‘not at all helpful’ and 7 denoted ‘extremely helpful’) and the extent to which the guidance enabled them to make a better judgment by circling the rating choice on a seven-point Likert scale (where 1 denoted ‘not at all’ and 7 denoted ‘to a great extent’).

4.3.4 Manipulation of example

The third and fourth versions of the instrument were prepared to vary the implications of the similarities presented in examples (affirmative and counter) on the respondents’ reporting judgments. If the investor directly or indirectly holds (through subsidiaries) 20 percent or more of the voting power of the investee, it is presumed that the investor has significant influence. Therefore, the first key indicator (voting power percentage) was deliberately kept at 18 percent in all materials (the scenario, the affirmative example and the counter example) so that the accountants were required to exercise judgments on the appropriate accounting treatment based on the other three key indicators of the existence of significant influence by an investor.

In the third version of the instrument, the participants were provided with an affirmative example as guidance that described a situation in which all three key facts relating to the scenario supported accounting for the investment as an associate (i.e. significant influence exists over an investee). In the fourth version, the participants were provided with a counter example as guidance that described a situation in which all three key facts relating to the scenario did not support accounting for the investment as an associate (i.e. significant influence does not exist over an investee). The participants were asked to refer to the example provided as guidance and then record their judgment as to whether the investee could be treated as an associate of the company on a seven-point Likert scale where 1 denoted ‘strongly disagree’ and 7 denoted ‘strongly agree’.

The manipulation check for example types was conducted post-experiment, and participants were asked to indicate the level of help the example provided in making their judgment by circling the rating choice on a seven-point Likert scale (where 1 denoted ‘not at all helpful’ and 7 denoted ‘extremely helpful’) and to indicate the extent to which the example enabled them to make a better judgment by circling the rating choice on a seven-point Likert scale (where 1 denoted ‘not at all’ and 7 denoted ‘to a great extent’).

In the fifth version of the instrument, the participants were provided with explicit guidance (both IFRS for SMEs and full IFRS) and the two examples (affirmative and counter) as guidance. The participants were asked to refer to the explicit guidance and examples provided and then record their judgment as to whether the investee could be treated as an associate of the company on a seven-point Likert scale where 1 denoted ‘strongly disagree’ and 7 denoted ‘strongly agree’.

In addition to providing their judgment on the scenario, respondents were asked to identify the perceived level of complexity of the scenario by circling the rating choice on a seven-point Likert scale (where 1 denoted ‘not complex’ and 7 denoted ‘extremely complex’). Furthermore, the respondents were asked to indicate the level of their familiarity in dealing with similar scenarios by circling the rating choice on a seven-point Likert scale (where 1 denoted ‘not familiar’ and 7 denoted ‘very familiar’).

4.3.5 Pre-test

To obtain an indication of the accounting treatment that best reflected the underlying economics of transaction and event in the financial statements (i.e., the most accurate judgment) on the scenario, this study conducted a pre-test. The research instrument was pre-tested with five accountants (members of the CPA Australia) and five senior academics from the host university. Each participant in the pre-test group made their reporting judgment on the scenario with the help of the guidance provided in both IFRS for SMEs and full IFRS. The mean score of the judgment made by all the participants in the pre-test is an indication of judgment consensus amongst the participants, and this study uses consensus in the judgment of experts as a proxy for judgment accuracy in the case (see Solomon & Shields, 1995).

Section 14 *Investments in Associates* of IFRS for SMEs provides guidance on how to identify significant influence. As specified in paragraphs 14.3 a, b and c, if an investor holds, directly or indirectly (e.g. through subsidiaries), 20 percent or more of the voting power of the associate, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly (e.g. through subsidiaries), less than 20 percent of the voting power of the associate, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not preclude an investor from having significant influence (IASB, 2009a, p. 81).

In addition to the guidance provided in IFRS for SMEs, paragraphs 6 to 9 of IAS 28 *Investments in Associates and Joint Ventures* of full IFRS provide additional guidance to determine the existence of significant influence by an investor. According to the information provided in the given scenario, the evidence on the existence of significant influence is satisfied. In the given case scenario, the company holds 18 percent of the voting shares and the company does not always have board representation for most of the Board meetings. Nevertheless, there is evidence of material transactions between the company and the investee, and the provision of essential technical information to the investee. Based on an assessment of all the facts, it appears that the company has significant influence over the investee. Consequently, the most accurate judgment in this case is that the investee should be considered as an associate of the company.

The mean score of the judgments made by all the participants in the pre-test was used to determine whether the company should account for the investment as an associate. The mean score of the judgments made by all the participants in the pre-test group was 6.7

(non-tabulated), indicating that the company should account for the investment as an associate.[43]

4.4 RESULTS

4.4.1 Demographic details of respondents

148 professional accountants participated in this experiment. As shown in Table 4.1, of the 28 respondents in IFRS for SMEs guidance group, 15 were male and 13 were female; of the 29 respondents in full IFRS guidance group, 12 were male and 17 were female; of the 31 respondents in the affirmative example group, 15 were male and 16 were female; of the 29 respondents in the counter example group, 14 were male and 15 were female; of the 31 respondents in the all guidance group, 18 were male and 13 were female. The mean age category of the respondents in each group was 32 years. The average number of years in formal education was 18 years for the respondents in the affirmative example group and 17 years each for the rest of the groups. The average professional experience level was 4.21 years for IFRS for SMEs guidance group, 4.39 years for full IFRS guidance group, 4.68 years for the affirmative example group, 5.56 years for the counter example group, and 7.42 years for the all-guidance group.

4.4.2 Tests of hypotheses

4.4.2.1 Effects of the reduced guidance in IFRS for SMEs on the reporting judgments of accountants (H1)

H1 is tested using one-way Analysis of Variance (ANOVA) where the guidance type (IFRS for SMEs guidance or full IFRS guidance) is the between-subject independent variable and the judgment type (strongly agree or strongly disagree) is the within-subject dependent variable. A seven-point Likert scale is used to test the accuracy of the reporting judgment, where 1 denotes ‘strongly disagree’ and 7 denotes ‘strongly agree’. ‘Strongly agree’ indicates an accurate judgment in this case.

[43] Accountants were asked to record their judgment on whether the company could account for the investment as an associate. They were asked to provide their judgment on the matter on a seven-point Likert scale (where 1 denoted ‘strongly disagree’ and 7 denoted ‘strongly agree’).

H1 predicts that differences in judgments may exist between those accountants who refer to the reduced guidance in IFRS for SMEs and those accountants who refer to full IFRS guidance in making their judgments. The ANOVA results reveal that the accountants in the full IFRS guidance group make accounting for investments in associates decisions that best reflect the economic substance of a transaction (mean = 4.66) compared to the accountants in the IFRS for SMEs guidance group (mean = 3.82, F = 4.106, p = 0.048). The results support H1 and suggest that the accountants' ability to choose the accounting treatment that best reflects the economic substance of a transaction is diminished when the guidance is reduced from IFRS for SMEs. Thus, IFRS for SMEs guidance is insufficient for making accurate judgments. The results are reported in Table 4.2.

4.4.2.2 Effects of examples provided in IFRS for SMEs as guidance on the reporting judgments of accountants (H2)

H2 is tested using one-way ANOVA where the example type (affirmative or counter) is the between-subject independent variable and the judgment type (strongly agree or strongly disagree) is the within-subject dependent variable.

H2 predicts that examples provided as guidance are likely to bias the reporting judgments of accountants towards the similarities presented in the examples. The ANOVA results indicate that judgments made by accountants in the affirmative example group were significantly different (mean = 4.61) to the judgments made by the accountants in the counter example group (mean = 3.38, F = 11.190, p = 0.001). The ANOVA results are reported in Table 4.3.

To explore the associations between the direction of the accounting treatment illustrated in the examples (affirmative/counter) and the judgments of accountants, Pearson correlation analysis was conducted. It is expected that the direction of the examples and the judgments of accountants are positively correlated.[44] Consistent with the expectation, correlation between the two variables is significant and the two variables are positively correlated (Pearson correlation coefficient = 0.402, 2-tailed p = 0.001) indicating that the judgments

[44] A lower value '1' was assigned for a counter example and a higher value '2' was assigned for an affirmative example, with the expectation that judgments would be biased towards 'strongly disagree' (lower value in Likert scale) when provided with a counter example, whereas judgments would be biased towards 'strongly agree'(higher value in Likert scale) when provided with an affirmative example.

of the accountants who were provided with affirmative examples were biased towards recognizing the investment as an associate, whereas the judgments of the accountants who were provided with counter examples were biased towards not recognizing the investment as an associate. The follow-up non-parametric correlation tests also show that correlation between the two variables is highly significant and is positively correlated (Kendall's correlation coefficient is 0.341, 2-tailed $p = 0.003$ and Spearman's correlation coefficient is 0.382, 2-tailed $p = 0.003$). The results of the correlation analyses are reported in Table 4.4. The results in Tables 4.3 and 4.4 provide strong support for H2 by indicating that accountants' reporting judgments are biased towards the similarities presented in examples, as they tend to map the relationships between similar features in the examples and their own decision contexts.

4.4.2.3 Effects of explicit guidance versus examples in IFRS for SMEs on the reporting judgments of accountants (H3)

H3 is tested using one-way ANOVA where the explicit guidance (IFRS for SMEs or full IFRS) and example type (affirmative or counter) are the between-subject independent variables and the judgment type (strongly agree or strongly disagree) is the within-subject dependent variable.

H3 predicts that accountants receiving explicit guidance are likely to make more accurate judgments than those receiving examples as guidance. The mean judgments indicate that the most accurate judgment was made by the accountants in the explicit guidance group (those who refer to full IFRS guidance) with a mean of 4.66. The ANOVA results indicate that judgments made by the accountants in the examples group were significantly different (mean = 4.02) to the judgments made by the accountants in full IFRS guidance group (mean = 4.66, $F = 3.698$, $p = 0.058$), whereas judgments made by the accountants in the examples group were not significantly different (mean = 4.02) to the judgments made by the accountants in IFRS for SMEs guidance group (mean = 3.82, $F = 0.276$, $p = 0.601$). These results in Table 4.5 provide support for H3 by indicating that explicit guidance is relatively more effective than examples, but only when detailed explicit guidance is available.

4.4.2.4 Effects of explicit guidance and examples in IFRS for SMEs on the reporting judgments of accountants (H4)

H4 is tested using one-way ANOVA where the explicit guidance (IFRS for SMEs or full IFRS) and example type (affirmative or counter) are the between-subject independent variables and the judgment type (strongly agree or strongly disagree) is the within-subject dependent variable.

H4 predicts that accountants receiving a combination of examples and explicit guidance will make more accurate judgments than those receiving either examples or explicit guidance alone. The mean likelihood judgments indicate that the most accurate judgment was made by the all-guidance group (a combination of examples and explicit guidance) with a mean of 4.68. The ANOVA results indicate that the judgments made by the accountants in the all-guidance group were significantly different (mean = 4.68) to the judgments made by the accountants in the examples group (mean = 4.02, F = 4.971, p = 0.028). This result suggests that bias towards the similarities presented in examples can be avoided by combining the examples with explicit guidance.

The ANOVA results further indicate that the judgments made by the accountants in the all-guidance group were significantly different (mean = 4.68) to the judgments made by the accountants in IFRS for SMEs group (mean = 3.82, F = 5.858, p = 0.019). This result suggests that limited guidance in IFRS for SMEs is insufficient for making accurate judgments—this argument is also supported by H1. However, the ANOVA results indicate that the judgments made by the accountants in the all-guidance group were not significantly different (mean = 4.68) to the judgments made by the accountants in full IFRS guidance group (mean = 4.66, F = 0.007, p = 0.936). The ANOVA results are provided in Table 4.6. While the findings support H4, these results confirm overall the idea that detailed explicit guidance is sufficient for influencing judgments, but that the examples are too influential in making judgments—this argument is supported by H2.

4.5 SUMMARY AND CONCLUSIONS

Most countries have moved towards adopting IFRS for SMEs in the belief that this stand-alone set of standards will improve the quality of their SME financial reporting. This study provides novel evidence from a country that has adopted IFRS for SMEs on the effectiveness of this set of standards in guiding accounting choices. This study reports the results of an experiment investigating the impact of the reduced guidance in IFRS for SMEs on the reporting judgments of accountants. Furthermore, this study explores whether the IASB's objectives of improving the comparability and reporting quality of SME financial reporting are achieved by the simplified IFRS for SMEs.

By providing explicit directions on allowable and disallowable accounting treatments, the standard setters/regulators anticipate that accounting standards and guidelines will appropriately communicate the underlying principles; hence, accountants should make similar judgments in identical accounting circumstances. The findings of this study reveal that accountants who refer to the reduced guidance in IFRS for SMEs are unlikely to choose the accounting treatment that best reflects the economic substance of a transaction compared to those who refer to detailed guidance in full IFRS.

The findings of this study also reveal that accountants tend to overstate the similarities presented in examples, thus biasing their judgments towards the treatment illustrated in the examples. The findings also indicate that the relative effectiveness of explicit guidance versus examples varies between the types of explicit guidance provided (IFRS for SMEs and full IFRS). The results reveal that accountants receiving explicit guidance are likely to make more accurate judgments than those receiving examples as guidance only when detailed explicit guidance (full IFRS guidance) is provided. The study further reveals that accountants receiving a combination of examples (affirmative and counter) and explicit guidance (IFRS for SMEs guidance and additional guidance in full IFRS) make significantly more accurate judgments than those receiving IFRS for SMEs guidance or examples alone. However, the study finds no significant differences in judgments between the accountants receiving a combination of examples (affirmative and counter) and explicit guidance (IFRS for SMEs guidance and additional guidance in full IFRS), and those receiving full IFRS guidance alone. Overall, the findings confirm that the guidance provided in IFRS for SMEs is insufficient for making sound judgments and may impair the accuracy of reporting judgments. Further, the directional effects of examples potentially influence the accuracy of judgments; as such, examples cannot be considered as effective guidance when they are presented alone.

Since IFRS for SMEs are gaining global prominence, this study provides important empirical evidence on the effectiveness of IFRS for SMEs. Generally, the findings stress that IFRS for SMEs with reduced guidance are likely to weaken the reporting judgments of accountants, thereby impairing the comparability of SME financial reporting. Enhanced comparability and better quality financial reporting for SMEs have been promoted as the major benefits of adopting IFRS for SMEs. The ability of accountants to apply the principles in IFRS for SMEs to specific accounting issues using the reduced guidance is crucial to achieving high quality reporting and consistent judgment outcomes. The findings suggest that comparability can be improved by providing sufficient guidance on appropriate accounting treatments. This is one of the reasons why many accounting regulatory bodies worldwide have emphasized the need to align the two sets of standards (IFRS for SMEs and full IFRS) during the comprehensive review process of IFRS for SMEs.

The findings of this study have important implications for accounting regulators. The IASB’s objective of introducing IFRS for SMEs is centred on a new paradigm of enhancing decision usefulness and reducing the information asymmetry of the financial information provided by SMEs across the globe. The findings from this study have two important implications for the IASB in achieving these objectives. First, the IASB may need to reconsider the implementation of reduced disclosure in IFRS for SMEs and retain recognition and measurement principles and implementation guidance that are identical to full IFRS, i.e. similar to the approach adopted in developed countries like Australia and New Zealand. This approach may also attract other developed countries to adopt IFRS for SMEs. Second, the IASB should be attentive when supplementing explicit guidance with examples. Therefore, the findings will be of interest to the IASB when shaping the optimal format for accounting standards—IFRS for SMEs in particular. The findings are also important to the broader international accounting community who have already adopted or intend to adopt IFRS for SMEs in their individual jurisdictions, particularly those regulatory bodies who intend to minimise the complications inherent in adopting two different versions of accounting standards in the same jurisdiction.

It is important to note that the experiment of this study focuses on a setting in which the impact of the reduced guidance on the reporting judgment of accountants is examined across one decision context, i.e. recognition of investments as an associate. To broaden the generalizability of the results, future studies could explore the impact of reduced guidance on the reporting decisions of financial statement preparers in other contexts where the guidance of IFRS for SMEs is significantly reduced compared to full IFRS guidance. The findings of this study could also be usefully extended in further research by the introduction of personal traits/skills variables (e.g. professional expertise) and task complexity variables to investigate the interactive effects of those variables and guidance on the reporting judgments of accountants. While this study provided no incentives to the accountants to influence their reporting judgments, future studies could examine the bias towards similarities in the examples when accountants are presented with explicit incentives for accurate reporting. Future studies could also explore other ways in which the bias towards similarities in examples could be avoided, to preserve the accuracy of the reporting judgments.

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Table 4.1: Demographic data of the respondents

Demographic Data	IFRS for SME Guidance Group		Full IFRS Guidance Group		Affirmative Example Group		Counter Example Group		All-Guidance Group	
Sample Size	28		29		31		29		31	
Gender	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
	15	13	12	17	15	16	14	15	18	13
Age (mean)	32		32		32		32		32	
Level of formal education in years (mean)	17		17		18		17		17	
Level of professional experience in years (mean)	4.21		4.39		4.68		5.56		7.42	

Table 4.2: Descriptive statistics and ANOVA results for effects of the reduced guidance in IFRS for SMEs on the reporting judgments of accountants

Guidance Type	Mean	Standard Deviation	F	p-value
IFRS for SMEs guidance group n = 28	3.82	1.786	4.106	0.048**
Full IFRS guidance group n = 29	4.66	1.289		

**Significant at $p < 0.05$

Table 4.3: Descriptive statistics and ANOVA results for effects of example types provided as guidance on the reporting judgments of accountants

Example Type	Mean	Standard Deviation	F	p-value
Affirmative example group n = 31	4.61	1.564	11.190	0.001***
Counter example group n = 29	3.38	1.265		

***Significant at $p < 0.01$

Table 4.4: Correlation analysis between the example type and the judgments of accountants

Source		Example type	Judgment
Example type	Pearson Correlation	1.000	0.402
	Sig. (2-tailed)		0.001***
Judgment	Pearson Correlation	0.402	1.000
	Sig. (2-tailed)	0.001***	
	n	60	60
Example type	Kendall's tau_b correlation coefficient	1.000	0.341
	Sig. (2-tailed)		0.003***
Judgment	Kendall's tau_b correlation coefficient	0.341	1.000
	Sig. (2-tailed)	0.003***	
	n	60	60
Example type	Spearman's rho correlation coefficient	1.000	0.382
	Sig. (2-tailed)		0.003***
Judgment	Spearman's rho correlation coefficient	0.382	1.000
	Sig. (2-tailed)	0.003***	
	n	60	60

***Significant at $p < 0.01$

Table 4.5: Descriptive statistics and ANOVA results for the effect of explicit guidance versus examples on the reporting judgments of accountants

Guidance Type	Mean	Standard Deviation	F	p-value
Full IFRS guidance group	4.66	1.289		
n = 29			3.698	0.058*
Examples group				
n = 60	4.02	1.546		
IFRS for SMEs guidance	3.82	1.786		
n = 28			0.276	0.601
Examples group				
n = 60	4.02	1.546		

*Significant at $p < 0.10$

Table 4.6: Descriptive statistics and ANOVA results for the effect of explicit guidance and examples on the reporting judgments of accountants

Guidance Type	Mean	Standard Deviation	F	p-value
All-guidance group n = 31	4.68	0.791	4.971	0.028**
Examples group n = 60	4.02	1.546		
All-guidance group n = 31	4.68	0.791	5.858	0.019**
IFRS for SMEs guidance group n = 28	3.82	1.786		
All-guidance group n = 31	4.68	0.791	0.007	0.936
Full IFRS guidance group n = 29	4.66	1.289		

**Significant at $p < 0.05$

CHAPTER 5

(PAPER 4)

User Perceptions of the Decision Usefulness of Financial Statements Prepared in Compliance with International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs)

ABSTRACT

The International Accounting Standards Board (IASB) has attempted to justify the simplification of International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs) in several ways, but no effective justification for this simplification has been made on the basis of the information needs of users. This study aims to provide empirical evidence of the decision usefulness of IFRS for SMEs from one of the main user groups of SME financial statements, namely, the banks. Using a questionnaire survey and follow-up interviews with senior commercial bank lending officers, this study examines the decision usefulness of the disclosure requirements and simplified recognition and measurement requirements of IFRS for SMEs. The findings of the study demonstrate that the reduced disclosure requirements of IFRS for SMEs are useful for bank lending decisions. The findings also indicate that bank lending officers have no major issues with the simplification of recognition and measurement principles, but they do not consider that such simplification significantly improves their lending decisions. These findings will be of great interest to accounting regulators, including the IASB, for evaluating the successful implementation of IFRS for SMEs, particularly when future amendments are made to IFRS for SMEs.

Keywords: Bank lending officers, decision usefulness, disclosure, IFRS, SMEs, SME lending

5.0 INTRODUCTION

Given the perceived burden of full International Financial Reporting Standards (IFRS) for small and medium-sized enterprises (SMEs), a clear need arose for a simplified set of standards for SMEs that would fulfil the cost-benefit requirements of preparers and users of SME financial reports (IASB, 2009a). IFRS for SMEs is a simplified version of full IFRS issued by the International Accounting Standards Board (IASB) in July 2009. The full set of IFRS was designed primarily to meet the financial information needs of equity investors in companies that trade securities in public capital markets. However, the user groups of non-publicly accountable entities, particularly SMEs, are different from the user groups of publicly accountable entities. Users of the financial statements of SMEs are considered to be tax authorities, banks, creditors, government agencies and owner-managers (Dang-Duc, 2011; Son, Marriott, & Marriott, 2006).

The IASB reports that the objective of SME financial statements is to provide financial information that is beneficial to a variety of users for economic decision making. The IASB (2009b) points out that the differences between full IFRS and IFRS for SMEs should be established based on the accounting information needs of users and cost-benefit considerations. Such views show that the accounting information needs of users have become an important benchmark in the differential reporting framework introduced by the IASB. The global convergence of the standards encourages SMEs to prepare their financial statements using IFRS for SMEs. The demand for high quality financial statements should be driven by the decision usefulness of the users, which in turn, will benefit SMEs in numerous ways, such as increasing their access to global competitive finance (IASB, 2009b).

Even though the simplification of IFRS for SMEs has been justified by the IASB in several ways (IASB, 2009b), no effective justification has been made for this simplification on the basis of the information needs of users. For instance, the Basis of Conclusion of IFRS for SMEs provides several explanations for the simplification of accounting treatments that mainly reflect cost-benefit reasons from the preparer's perspective rather than the user's perspective. The disclosure requirements of IFRS for SMEs have also been criticised by some accounting practitioners on the grounds that their inclusion may increase accounting and audit costs, yielding no real benefit to SMEs (ICAA, 2012). Schiebel (2008) demonstrates that the IASB has provided little opportunity for user participation in the consultation process during the development of IFRS for SMEs; instead, the major commentators have been auditors, accountants and standard setters. Further, the IFRS Foundation (2015a) acknowledges that the IASB received no comment letters from users of SME financial statements on the Exposure Draft for proposed amendments to IFRS for SMEs during its initial comprehensive review process. As other participants do not adequately represent the interests of users, the inadequate user involvement in the accounting standard setting process may impair the decision usefulness of accounting information for users (Durocher, Fortin, & Côté, 2007; Harding & Mckinnon, 1997).

The American Institute of Certified Public Accountants (AICPA) recommends that “the same measurement principles should be applied to the general purpose financial statements (GPFSs) of all entities, because the measurement process should be independent of the nature of the users and their interest in the resulting measures” (AICPA, 1976, p. 8). However, AICPA also notes that the disclosure requirements of the standards may vary depending on the accounting information needs of user groups. Therefore, it is questionable whether the divergence of full IFRS and IFRS for SMEs truly benefits the information needs of users.

The Basis for the Conclusion of IFRS for SMEs notes that one of the main groups of external users of SME financial information is represented by the banks, which provide loans to SMEs (IASB, 2009b, p. 28). The banking sector is a major actor in the credit market in many developed and developing economies, and they play an important role in creating a suitable enabling environment and easy access to credit for many SMEs. Many commercial banks are currently deviating from traditional lending systems such as collateral-based lending and are modernising their lending systems, based primarily on cash flow and project viability. Thus, the need for high quality accounting information has increased as the utilisation of financial data to assess company performance has grown (Kwok, 2002). On the other hand, critics contend that the need for high quality financial information and the international comparison of SME financial statements are of no use to SMEs. With regard to bank lending in particular, banks are in a position to demand the information they require, and therefore such a need does not necessarily arise.

Extant literature points out that little is known about real users and their information needs in relation to SME financial statements (see Dang-Duc, 2011; Evans et al., 2005; Sian & Roberts, 2006; Son et al., 2006). Even within the limited available literature, there is inconsistency in the findings on users and the information they require from SME financial statements, and these issues remain unaddressed (see Son et al., 2006).

Successful implementation of IFRS for SMEs and the need for improvement cannot be envisaged if user perceptions of the decision usefulness of IFRS for SMEs are not well understood. This study aims to provide empirical evidence about the decision usefulness of SME financial statements prepared in compliance with IFRS for SMEs on bank lending decisions. The decision usefulness of IFRS for SMEs was evaluated from two aspects of the standard: the decision usefulness of the reduced disclosure requirements of IFRS for SMEs, and the decision usefulness of the simplified recognition and measurement requirements of IFRS for SMEs. [45]

To address these issues, a survey was conducted in which 43 bank lending officers participated, and follow-up interviews with 19 senior bank lending officers were also conducted. The questionnaire survey was designed to understand the perception of bank lending officers about the decision usefulness of the reduced disclosure requirements of IFRS for SMEs on SME lending decisions. The follow-up interviews were conducted to gain in-depth insights into the appropriateness and economic consequences of the simplification of recognition and measurements requirements of IFRS for SMEs on bank lending decisions.

The results show that most of the disclosure requirements of IFRS for SMEs are found to be useful for bank lending decisions. However, bank lending officers did not consider all the disclosure requirements presented to them to be equally important for their lending decisions. In particular, disclosure items pertaining to the historical trends of profit and loss, interest coverage, short-term cash flow, liquidity and balance sheet were regarded as being of most use for their lending decisions. With regard to the simplification of recognition and measurement requirements, the findings indicate that bank lending officers

[45] McCaslin and Stanga (1986) note that the information needs of users of financial statements are a function of user measurement and disclosure needs.

have no major issues with the simplification of recognition and measurement principles, but they do not consider that such simplification significantly improves their lending decisions.

This paper contributes to the accounting literature in several ways. First, this is a pioneer study that examines the decision usefulness of simplified IFRS for SMEs on a major group of external users of SME financial statements – the banks. The findings provide insights into the debate on the differential reporting framework introduced by the IASB. The findings also indicate the need for users to be involved in the standard setting process. The findings will be of great interest to accounting regulators, including the IASB, for evaluating the successful implementation of IFRS for SMEs and when planning the next review of IFRS for SMEs. The study also highlights the need to enhance public awareness of the simplified IFRS for SMEs at the individual jurisdiction level. The findings of this study will help to fill a gap in the existing accounting literature, as much of the existing research into the accounting information needs of users is broadly investor-oriented.

The remainder of the paper is organised as follows. Section 5.1 discusses the relevant literature, and Section 5.2 outlines the theoretical framework used in this study. Section 5.3 describes the research methods. Section 5.4 presents the results from the survey, and Section 5.5 discusses the findings from the semi-structured interviews. Section 5.6 provides a summary and presents the conclusions and implications of the study.

5.1 RELEVANT LITERATURE

5.1.1 Users and their accounting information needs

Since the early 1980s, researchers have been interested in discovering whether the accounting information needs of diverse user groups of financial statements differ significantly. An ongoing debate on user groups of financial statements highlights that users of financial statements are not a homogeneous group. For example, based on the assumption that the ability of a company to generate favourable cash flow is the central interest of both investors and creditors, McCaslin and Stanga (1986) conducted a study to investigate whether the accounting measurement needs between financial analysts and loan officers are similar. They conducted a questionnaire survey with financial analysts and chief commercial loan officers in the context of common stock investment decisions and term loan decisions respectively. Their findings reveal that the accounting measurement needs of the two user groups are generally similar.

Stanga and Tiller (1983) conducted a study to compare the informational needs of bank loan officers in relation to large public companies and small private companies respectively. Their study was based on the assumption that the accounting information needs of users of the financial statements of small companies differ from the accounting information needs of users of the financial statements of large companies. A questionnaire survey of chief commercial loan officers provided evidence that there are no substantial differences between large public companies and small private companies in respect of accounting information needs for making lending decisions. Some accounting information, however, such as lease capitalisation, was found to be less important to smaller companies than it is to large companies. Street and Stanga (1989) conducted a survey to examine the relevance of a segment cash flow statement in the lending decisions of commercial bank loan officers on the assumption that segment cash flow statements would help to build confidence in decision makers about a company's ability to generate future cash flows. The results reveal that commercial bank loan officers consider that segment cash flow statements, if available, are relevant for their lending decisions, therefore the disclosure of segment cash flow statements is considered to be an important factor that may affect lending decisions.

With the growing significance of cash flow statements (Jones & Ratnatunga, 1997), researchers have been extensively interested in investigating the importance of cash flow information in bank lending decisions and have found evidence that bank lending officers consider the information conveyed by the cash flow statements to be most useful for their lending decisions (Billings & Morton, 2002; Jones, Romano, & Smyrnios, 1995; Kwok, 2002; Yap, 1997). Jones et al. (1995) conducted a survey in the Australian context to obtain managerial perceptions about the decision usefulness of cash flow statements. The study provides evidence that cash flow statements are perceived to be useful in a wide range of internal and external decision contexts; nevertheless, Yap (1997) raised concerns about the findings of Jones et al. (1995) and argued that the usefulness of cash flow statements must be measured against the responses of external users who actually use financial statements. Accordingly, Yap (1997) employed a sample of respondents from the Australian finance industry to investigate the usefulness of cash flow statements on investment and lending decisions. The findings confirm that cash flow statements are useful for making decisions, especially with regard to evaluations of liquidity, solvency and financial flexibility. Billings and Morton (2002) examined the relevance of disclosing operating cash flow to creditors. Their findings provide evidence that operating cash flow is considered to be an important determinant of credit risk, measured by a firm's debt rating.

Prior research also provides mixed evidence about the decision usefulness of annual financial statements, including cash flow statements, in lending decisions (Allen & Cote, 2005; Kitindi, Magembe, & Sethibe, 2007; Kwok, 2002). For example, Kwok (2002) conducted an experiment with four user groups of financial statements: bank lending officers, auditors, financial analysts and accounting academics, to investigate the use of cash flow information in lending decisions. The findings of the study demonstrate that the respondents used cash flow information when making lending decisions, but that the information was obtained from notes to the balance sheet and other reports rather than from the cash flow statement.

Allen and Cote (2005) in their experiment provided evidence that creditor reliance on earnings is high, relative to operating cash flow, in the assessment of creditworthiness. Allen and Cote (2005) also noted that decision-making behaviour is similar for both creditors and investors. Similarly, Kitindi et al. (2007) found evidence that income statement information is the most useful information source because lenders consider profitability to be an indicator of the borrower's future prospects and ability to service the loan, rather than the liquidity and net worth conveyed in the balance sheet and cash flow statements. Abu-Nassar and Rutherford (1996) provided similar evidence in the context of a less developed country, Jordan. Their study provides evidence that bank loan officers use the information in the balance sheet and income statements more extensively than other sections of the financial statements.

Prior studies have also attempted to establish the usefulness of accounting information from audited reports and accounting standards. There is wide-spread agreement among users that the accounting information in financial statements is more reliable when it is audited and prepared in compliance with accounting standards or Generally Accepted

Accounting Principles (GAAP) (Abu-Nassar & Rutherford, 1996; Baker & Cunningham, 1993; Gómez-Guillamón, 2003; Kent & Munro, 1999; Kitindi et al., 2007).

Baker and Cunningham (1993) examined the perceptions and behaviours of loan officers faced with financial statements prepared on different accounting bases and service levels.[46] A survey of bank loan officers revealed that the decision to grant a loan is not affected by the accounting base or service level. The authors found that interest rate perception is not a function of the accounting basis; however, their findings reveal that loan officers have more confidence in the audited financial reports if they have been prepared using GAAP, and they have more confidence in income tax basis statements if they have been reviewed. The findings indicate that "…the interaction of accounting basis and service level did affect respondents' perceptions of confidence that the financial report reflected the financial position of the prospective borrower" (p. 474).

Similarly, Gómez-Guillamón (2003) argues that bank officers ensure the accuracy of financial information by requiring their clients to provide audited reports. Gómez-Guillamón (2003) investigated the opinions of bank officers (and auditors in particular) about the usefulness of audited reports for making financing decisions. A survey of credit institutions revealed that these institutions regard the information in the auditor's report as relevant and useful, and it impacts their decisions on whether or not to grant a loan, as well as being a factor in the amount of loan to be granted. The author additionally finds similar evidence from the investors' perspective.

Abu-Nassar and Rutherford (1996) provided evidence that in contrast to developed countries, user groups in less developed countries such as Jordan place greater importance on the information contained in the auditors' report. The authors indicated that this difference is mainly due to the weak regulatory financial reporting environment in less developed countries. In the absence of a strong legal backing for financial reporting, preparers are only required to maintain accurate accounting records in accordance with

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[46] Baker and Cunningham (1993) regarded GAAP and income tax basis as 'accounting bases' and audited and reviewed financial statements as 'service levels'. While an audited report provides assurance that "an organization's financial statements are free from material misstatements", a reviewed report provides limited assurance (based on an accountant's review) that "no material modifications to the financial statements are necessary" (AICPA, 2010, p. 1).

GAAP. The reliability of the information disclosed in audited reports in such cases increases significantly.

Kent and Munro (1999) conducted an experiment with loan officers from major Australian banks to investigate the impact of differential reporting on bank lending officers' decisions on borrower repayment ability. Their results reveal that the assessment of a borrower's repayment ability is not affected by the presentation of GAAP or non-GAAP financial reports. However, loan officers tend to request additional information when non-GAAP reports are presented to reduce uncertainty and enhance reliability.

5.2 THEORETICAL FRAMEWORK

5.2.1 Decision usefulness of accounting information

The theoretical framework of this study utilises decision-usefulness theory.[47] This theory, instigated by Staubus (2000, p. v), contends that "the key to the decision-usefulness theory is the decision-usefulness objective". The decision-usefulness approach assumes that the basic objective of accounting is to aid the decision-making process of certain 'users' of accounting reports by providing useful, or relevant, accounting data (Godfrey, Hodgson, Tarca, Hamilton, & Holmes, 2010, p. 24).

As noted by Staubus (1975), the intended economic consequence of the decision-usefulness objective of accounting is to improve the economic decision making of users. The IASB (2009b) asserts that the objective of financial statements is to provide information about the financial position, financial performance, and cash flow of an entity that is useful to a wide range of users in making economic decisions. Generally, the term 'economic' refers to a situation involving scarce resources in which a choice must be made. The resource providers are the investors and creditors. In its conceptual framework for financial reporting, the IASB specifies that economic decisions may include whether a user should hold or sell their investments in the entity; however, this statement is favourably oriented towards the investor (IFRS Foundation, 2013b).

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[47] Many prior studies have been conducted within the decision usefulness framework to assess the usefulness of the information in financial reports (see Gassen & Schwedler, 2010; Hitz, 2007; Hooks & van Staden, 2004 for a review).

From a bank lending perspective, the implication of lending decisions is such that the recovery of loan funds must be managed efficiently to guarantee the liquidity position of the bank to protect the interest of depositors. Decisions on the allocation of resources or funds may include whether or not to proceed with advancing a loan, thus the decision usefulness of bank lending can be established on the basis of the bank's ability to accurately evaluate a borrower's creditworthiness and the bank's credit risk. Creditworthiness assesses the likelihood of a borrower defaulting on their debt obligations. Credit risk is the risk of loss of principal or loss of a financial reward stemming from a borrower's failure to repay a loan or otherwise meet a contractual obligation.

McCaslin and Stanga (1986) note that the decision usefulness of SME accounting information for bank lending decisions must be evaluated in terms of both the measurement needs and disclosure needs of bank lending officers. IFRS for SMEs are simplified in measurement and recognition requirements, and in disclosure requirements. Claims made by the IASB articulate that accounting standard setting is based on the decision usefulness of accounting information. For example, the IASB (2009b) states that the differences between full IFRS and IFRS for SMEs should be established based on the accounting information needs of users and cost-benefit considerations. Such views show that the decision usefulness of accounting information has been an important benchmark in the differential reporting framework introduced by the IASB. Thus, it is expected that IFRS for SMEs will be particularly responsive to the information needs of users.

This study anticipates that bank lending officers will perceive the reduced disclosures and simplified recognition and measurement concepts in IFRS for SMEs as being particularly useful for assessing creditworthiness and credit risk when making their lending decisions for SMEs. Accordingly, the decision usefulness of IFRS for SMEs on bank lending decisions is measured from two aspects in this study: (1) the decision-usefulness of reduced disclosure requirements of IFRS for SMEs, and (2) the decision-usefulness of simplified measurement concepts and recognition requirements of IFRS for SMEs (see Figure 5.1).

5.3 RESEARCH APPROACH

5.3.1 Research setting

For the purpose of this study, it was determined that the research setting should represent a country that has adopted IFRS for SMEs. Sri Lanka has taken the lead in adopting IFRS for SMEs in the South Asia region, and shortly after the Standard was issued in 2009, required all entities not identified as 'listed entities' to comply with IFRS for SMEs for the reporting period beginning on or after 1st January 2012. The new Sri Lankan equivalents of IFRS for SMEs is a completely stand-alone set of standards. More than 18,000 companies currently operate in Sri Lanka, of which approximately 91% are SMEs (World Bank, 2011). Therefore, the financial reporting setting and the vibrant SME sector in Sri Lanka provides an appropriate research setting for the current study.

This study was conducted in licenced commercial banks (LCBs) in Sri Lanka. The loan composition of LCBs indicates that the largest customer segment of LCBs is the corporates, which also includes SMEs and accounts for 57% of the total number of LCB loans (Fitch Ratings Sri Lanka, 2012). Corporate loans focus more on accounting information which better serves the objective of this study. Thus, this study focuses only on commercial lending decisions and excludes personal, housing, pawning and credit card loans.

There are 24 licenced commercial banks (LCBs) operating in Sri Lanka, of which eight are privately-owned local commercial banks, four are state-owned commercial banks and 12 are foreign bank branches (Central Bank of Sri Lanka, 2014). Of the eight privately-owned local LCBs, the four largest LCBs participated in this study. These four largest LCBs hold about 34% of market share by loans (Fitch Ratings Sri Lanka, 2012). The lending schemes of state-owned banks for SMEs are mostly supported by various project schemes, therefore their loan approval decision process is different from that of privately-owned LCBs. State-owned LCBs, foreign bank branches and small LCBs were therefore excluded from this study.

5.3.2 Research method

This study uses a mixed-method approach to address the research questions. First, a survey was conducted on commercial bank lending officers to assess the usefulness of different disclosure items included in the SME financial statements, which are prepared in accordance with IFRS for SMEs. Second, semi-structured interviews were conducted with commercial bank lending officers to gain an in-depth insight into the appropriateness and economic consequences of the simplification of the recognition and measurements requirements of IFRS for SMEs on their lending decisions.

5.3.2.1 Participants

Senior bank lending officers from the four largest LCBs in Colombo, Sri Lanka were chosen as the participants in the survey. The questionnaire was distributed among 70 senior bank lending officers. 43 valid responses were received, yielding a usable response rate of 61%. The sample was limited to the four largest commercial banks to increase the likelihood that the lending officers surveyed would rely on the published accounting information of SMEs when making their lending decisions. It was important to select Sri Lankan-based bank lending officers who had experience in making lending decisions for SMEs, because the survey asked participants to choose accounting information that was considered to be useful for their SME lending decisions.

At the end of the questionnaire, participants were invited to indicate their interest in participating in a follow-up interview. Over 80% of respondents (32) indicated that they would like to participate in a follow-up interview. To ensure a representative sample of bank lending officers from each banks, the stratified sampling procedure was used to randomly choose 19 participants for the follow-up interviews.

5.3.2.2 Survey questionnaire

In the first part of the survey questionnaire, respondents were required to provide demographic data such as gender, age, level of formal education, education qualifications and years of experience in SME lending (Appendix 4). The respondents were also asked to indicate their level of familiarity with the Sri Lankan equivalents of IFRS for SMEs (measured on a five point Likert scale where 1 denoted ‘not familiar’, and 5 denoted ‘very familiar’).

The second part of the survey questionnaire comprised two sections. The first section contained four questions. The first two questions were designed to assess the importance that the participants placed on different sources of information when evaluating a loan application by SMEs. The second two questions were designed to evaluate participants’ opinions on the usefulness of different accounting measurement concepts of assets and liabilities when making a term-loan decision. The survey instrument developed by Gassen and Schwedler (2010), which investigates the decision usefulness of different accounting measurement concepts for investment decisions, was used as a guide in designing these questions, which were appropriately customised to reflect the opinions of bank lending decisions. All questions required the participants to give their opinion on a five-point Likert scale.

The second section of the questionnaire consisted of a set of information items that are considered to be useful when making a term-loan decision for SMEs. Accounting information items that would be relevant for users in their decision making were selected for this study, and these information items were generally based on the IFRS for SMEs presentation and disclosure checklist (IASB, 2009c). This section consisted of 56 accounting information items. Of the 56 information items in the questionnaire, 18 items pertained to the statement of financial position (balance sheet), seven items pertained to the sub-classifications in the balance sheet or in the notes, 14 items pertained to the income statement and the statement of comprehensive income, four items pertained to the statement of changes in equity and the statement of income and retained earnings, nine items pertained to the cash flow statement and four items pertained to the notes to the financial statements. Respondents were asked to evaluate the usefulness of each item on a five-point Likert scale (where 1 denoted ‘not useful’ and 5 denoted ‘extremely useful’). The number of information items in each classification is reported in Table 5.1.

The respondents were instructed to evaluate each information item independently in the context of making a typical term-loan decision for an SME. The respondents were also asked to assume that they were dealing with a typical new customer. All the instructions were provided in the questionnaire to establish an appropriate decision context.

5.3.2.3 Validity of the survey questionnaire

Cronbach's alpha test was conducted to verify the internal validity and consistency of the 56 accounting information items in the questionnaire. The alpha coefficient obtained for the 56 accounting items is 0.931, suggesting that the items have high internal consistency (Cronbach, 1951), which verifies the reliability of the survey questionnaire.

5.3.2.4 Semi-structured interviews

Semi-structured interviews were conducted with senior commercial bank lending officers in the four largest private licenced commercial banks (LCBs) in Sri Lanka. A total of 19 interviews were conducted. The interviews were conducted at the bank premises of the interviewees. One interview was conducted via telephone due to the unavailability of the interviewee at the scheduled interview times. All interviewees were required to read and sign the participant information and consent form before responding to the interviews (Appendix 5). To assure anonymity and promote consistent and reliable responses, all interviewees were informed that the identity of the respondent and the bank would remain anonymous. All the interviews were audio recorded with the permission of the interviewees. The audio files were then transcribed using NVivo 10 software and copies of the transcriptions were emailed to each interviewee for verification and validation. The duration of the interviews ranged from 30 minutes to one hour.

An interview guide was prepared which addressed three objectives (Appendix 4). The main objective was to understand the perception of bank lending officers on the usefulness of simplified recognition and measurement requirements in IFRS for SMEs in relation to their lending decisions. The semi-structured questions were mainly based on the issues raised during the initial comprehensive review of IFRS for SMEs carried out by the IASB in 2012.[48] The questions targeting the perceptions of the simplified measurement and recognition requirements of IFRS for SMEs focused on the prohibition of the revaluation policy option on property, plant and equipment, recognition of research and development costs as expenses when incurred, the usefulness of fair values for certain asset classes, and recognition of deferred tax accounting. Interviewees were asked to comment on the

[48] The objective of the Request for Information during the comprehensive review was to seek public views on whether there is a need to make amendments to IFRS for SMEs.

appropriateness and the economic consequences of this simplification to recognition and measurement requirements on their lending decisions. The perceptions of bank lending officers on the impact of certain topics omitted from IFRS for SMEs on their lending decisions were also obtained in the interviews.

Semi-structured questions were also designed to understand the general perception of bank lending officers on the role of accounting information on SME lending decisions, and their overall perception of the usefulness of financial statements prepared in compliance with IFRS for SMEs.

5.4 RESULTS AND DISCUSSION – THE SURVEY

5.4.1 Demographic details of the survey respondents

As indicated in Section 5.3, a questionnaire survey was carried out with 43 senior bank lending officers. Of the 43 participants in this survey, 81% were qualified members of the Institute of Bankers of Sri Lanka (IBSL)[49], of which 42% held a Diploma in Banking & Finance qualification and 35% held a Certificate in Banking & Finance qualification. The respondents had relevant education, training and experience in dealing with lending decisions for SMEs. As shown in Table 5.2, 29 of the 43 respondents in the survey group were male and 14 were female. The mean age category of the respondents was 37 years. The average number of years in formal education was 17 years. The average experience of SME lending was 8.65 years. The respondents were generally familiar with the Sri Lankan equivalents of IFRS for SMEs, as indicated by the mean response of 3.40.

5.4.2 Decision-making process of SME lending

To gather opinions about the decision making process applied by commercial bank lending officers when evaluating SME loan applications, two questions (Q1 and Q2) were designed that describe (1) lending practices banks use to evaluate SME loan applications, and (2)

[49] The IBSL is the only authorised professional body to offer banking qualifications in Sri Lanka (IBSL, 2015).

the usefulness of different sources of information when evaluating loan applications by SMEs.

The respondents were provided with four statements (Q1.1 – Q1.4), which describe four different practices for evaluating an SME loan application. The respondents were asked to rate whether the statements correctly described their practices for evaluating an SME loan application on a five-point Likert scale, where 1 denoted ‘strongly disagree’ and 5 denoted ‘strongly agree’. The mean responses for each of the four statements are reported in Table 5.3. Overall, the mean values reveal that the respondents assigned the highest agreement (mean = 3.93) to the statement “My method of analysis differs according to the respective client/company”. The statement with the second highest agreement (mean = 3.60) is “My lending decision is based on accounting information of the company”, followed by the statements “My lending decision is based on non-accounting information of the company” (mean = 3.53) and “My lending decision is based on first-hand information and impression of management quality” (mean = 3.47).

This analysis indicates that bank lending officers assign considerable weight to financial accounting information as a fundamental approach for evaluating SME loan applications. Thus, the initial analysis of this study provides an indication of the significance of assessing the usefulness of the accounting information needs of bank lending officers.

Question 2 was designed to gather the general perceptions of bank lending officers on the usefulness of accounting information sources compared to alternative sources of available information when making a term-loan decision for an SME. Altogether, fifteen sources of information were provided, including seven financial statement items. The respondents were asked to evaluate the usefulness of different sources of information on a five-point Likert scale where 1 denoted ‘not useful’ and 5 denoted ‘extremely useful’. The mean values reveal that of the annual financial statement items provided, bank lending officers view cash flow statement as the most useful information source (mean = 4.88), followed by income statement, balance sheet, statement of changes in equity and income & retained earnings and notes to the annual financial statements. Related party disclosures (mean = 3.67) and statement of accounting policies (mean = 3.51) are rated as less useful compared to the other financial statement items. Other than the annual financial statements, bank lending officers considered legal documents to be the most useful source of information (mean = 4.74), followed by general information about the client and business, business credit report, business plan, collateral documents, bank statements and list of guarantees proposed. Income tax returns were rated as least useful (mean = 3.35). The mean values are reported in Table 5.4.

5.4.3 Familiarity and attitude of bank lending officers to accounting measurement concepts

Two questions (Q3 and Q4) of the questionnaire survey were designed to capture the familiarity of bank lending officers with different accounting measurement concepts, and their general attitude towards these concepts when evaluating financial statements for SME lending decisions.

Question 3 was designed to capture the familiarity of bank lending officers with different accounting measurement concepts. The respondents were provided with four types of accounting measurement concepts and were asked to indicate their familiarity with each concept on a five-point Likert scale, where 1 denoted ‘not familiar’ and 5 denoted ‘very familiar’. Ranked by overall familiarity, the lower of cost or market concept was rated as the most familiar concept (mean = 4.05), followed by fair value (mean = 3.77) and historical cost concepts (mean = 3.56). The value-in-use measurement concept was rated as the least familiar concept (mean = 3.51). Overall, the lower of cost or market appears to be the most influential accounting measurement concept. The mean values are reported in Table 5.5.

In Question 4, five statements were included to seek the preferences of bank lending officers in respect of measurement concepts for reporting assets and liabilities in SME financial reports. Three statements sought opinion on whether assets and liabilities should be reported: (1) following the same measurement concept, (2) following different measurement concepts, or (3) by permitting companies to choose between alternative measurement concepts. Another two statements sought the opinions of bank lending officers on the reporting preferences between historical cost and fair value for assets and liabilities. Respondents were asked to give their opinions on these five statements on a five-point Likert scale where 1 denoted ‘strongly disagree’ and 5 denoted ‘strongly agree’. The mean values are reported in Table 5.6.

The mean values reported on each statement reveal that bank lending officers favour all assets and liabilities being reported according to the same measurement concept (mean = 4.12). The least mean value (mean = 2.93) indicates that bank lending officers are not in favour of firms having freedom to choose appropriate measurement concepts for different classes of assets or liabilities at their discretion. Given a choice between historical cost and fair values as the measurement concepts of valuing assets and liabilities, bank lending officers prefer fair values to be reported (mean = 3.63). The general conclusion derived from this finding is that bank lending officers prefer the use of fair values as a measurement concept in financial reporting. This finding is compatible with Gassen and Schwedler (2010), suggesting that measurement concept requirements between bank lending officers and investors are similar. The reasons why bank lending officers prefer fair value rather than historical cost is revealed by the semi-structured interviews conducted with bank lending officers, which will be discussed in Section 5.5.

5.4.4 Perceptions of bank lending officers on the usefulness of disclosure requirements of IFRS for SMEs on lending decisions

The first objective of this survey was to assess the opinions of bank lending officers on the usefulness of the disclosure requirements of IFRS for SMEs on their SME lending decisions. As mentioned earlier, 56 disclosure requirements were identified under six categories of financial statements.

Pearson’s Chi-square goodness-of-fit test was performed for each of the 56 accounting information items.[50] The Chi-square test values summarise the usefulness attributed by the

[50] For the purpose of analysis, the survey observations were combined and reclassified into new categories to ensure the adequacy of expected frequencies for computing the X^2 statistics (Benjamin & Stanga, 1977). Respondents who circled 4 and 5 on the five-point Likert scale (where 1 denoted ‘not useful’ and 5 denoted ‘extremely useful’) were reclassified, because they agreed that the information items were ‘useful’ for making their lending decisions (new value 3 was assigned). Respondents who circled 3 on the five-point Likert scale were reclassified because they agreed that the information items were neither useful nor not useful (‘neutral’) for making their lending decisions (new value 2 was assigned). Respondents circled 1 or 2 on the five-point Likert scale were reclassified because they agreed that the information items were ‘not useful’ for making their lending decisions (new value 1 was assigned). The frequency percentages of the perceived usefulness were then obtained for each of the 56 information items.

survey respondents to each disclosure requirement. The larger the Chi-square values, the closer the *p*-values are to zero, suggesting that there are statistically significant differences between respondents in the perceived usefulness of each of the disclosure items.

5.4.4.1 Decision usefulness of disclosure requirements of the statement of financial position (Balance sheet)

The information items 1 to 18 sought to establish the decision usefulness of the disclosure requirements of balance sheet items. The Chi-square test results show that there are statistically significant differences between respondents in the perceived usefulness of twelve disclosure items, with more bank lending officers perceiving the balance sheet items as 'useful', and fewer bank lending officers perceiving the information as either 'not useful' or 'neutral'. The disclosure of trade and other payables had a relatively high perceived usefulness (Q12): X^2 = 39.1, p = 0.000 (97.7% of respondents), trade and other receivables (Q2): X^2 = 74.4, p = 0.000 (95.4% of respondents), financial liabilities (Q13): X^2 = 25.3, p = 0.000 (88.4% of respondents), financial assets (Q3): X^2 = 50.0, p = 0.000 (83.7% of respondents), cash and cash equivalents (Q1): X^2 = 42.2, p = 0.000 (79.1% of respondents), inventories (Q4): X^2 = 31.3, p = 0.000 (72% of respondents), provisions (Q16): X^2 = 21.3, p = 0.000 (65.1% of respondents), investments in associates carried at fair value through profit or loss (Q10): X^2 = 16.0, p = 0.000 (60.5% of respondents), equity attributable to the owners of the parent (Q18): X^2 = 16.0, p = 0.000 (60.5% of respondents) and investment property carried at fair value through profit or loss (Q6): X^2 = 14.7, p = 0.001 (53.5% of respondents). Disclosure items such as property, plant and equipment measured at historical cost (Q5) and intangible assets (Q7) were regarded as useful by only 53.3% of respondents (X^2 = 9.1, p = 0.010) and 53.5% of respondents (X^2 = 8.4, p = 0.015) respectively, however, 46.7% and 46.5% of respondents respectively also regarded these two disclosures as either 'not useful' or 'neutral'.

The Chi-square test results, on the other hand, show that there are statistically significant differences between respondents in the perceived usefulness of three disclosure items, with more bank lending officers perceiving the information as either 'not useful' or 'neutral' and fewer bank lending officers perceiving the information as 'useful'. Relatively less perceived usefulness was found in disclosure items pertaining to non-controlling interest (Q17): X^2 = 19.0, p = 0.000 (72.1% of respondents), deferred tax assets and liabilities

(Q15): $X^2 = 6.2$, $p = 0.045$ (62.8% of respondents) and liabilities and assets for current tax (Q14): $X^2 = 5.6$, $p = 0.060$ (58.1% of respondents), suggesting that the majority of bank lending officers did not consider this information to be useful for their lending decisions.

The Chi-square test results further show that there are no statistically significant differences between respondents in the perceived usefulness in disclosure requirements of investments in jointly controlled entities carried at fair values (Q11): $X^2 = 4.2$, $p = 0.120$, biological assets carried at cost less accumulated depreciation and impairment (Q8): $X^2 = 3.5$, $p = 0.171$ and biological assets carried at fair values through profit or loss (Q9): $X^2 = 2.4$, $p = 0.298$. The results suggest that while some bank lending officers perceived these information items to be useful, others held a neutral opinion, and some bank lending officers found no usefulness in these items for their lending decisions. The Chi-square test results are reported in Table 5.7 and the percentage of frequency distribution of the responses is reported in Table 5.8.

These results indicate that bank lending officers agreed that 12 out of 18 disclosure requirements of the balance sheet were useful, although they were neutral about the six other disclosure requirements, or regarded them as not useful. The findings in Section 5.4.3 reveal that given a choice between historical cost and fair values as a measurement concept of valuing assets and liabilities, bank lending officers prefer fair values to be reported. This is further evidenced by the findings that 46.7% of bank lending officers held either a neutral opinion about the usefulness of the information about property, plant and equipment measured at historical cost or felt that it was not useful. However, the findings also indicate that the majority of bank lending officers are neutral about the usefulness of fair value information relating to investments in jointly controlled entities and biological assets. The majority of bank lending officers considered neither the historical cost value nor the fair value of biological assets as useful for their lending decisions. As far as agricultural accounting practices are concerned, farmers are reluctant to prepare financial statements; instead, accounts are prepared as a requirement of complying with tax regulations (Vazakidis, Stergios, & Laskaridou, 2010). Moreover, the valuation of biological assets is regarded as difficult and controversial for SMEs (ACCA, 2012). For these reasons, it can be assumed that bank lending officers may not have encountered agricultural accounting information very often and thus do not consider that this information is useful.

Information items 19 to 25 sought to examine the usefulness of the disclosure requirements of the sub-classification of certain balance sheet items. The Chi-square test results show that there are statistically significant differences between respondents in the perceived usefulness of five disclosure items, with more bank lending officers perceiving those sub-classifications as ‘useful’, and fewer bank lending officers perceiving them as either ‘not useful’ or ‘neutral’. The sub-classifications pertaining to trade and other receivables (Q20): X^2 = 69.0, p = 0.000 (93% of respondents), trade and other payables (Q22): X^2 = 28.5, p = 0.000 (90.7% of respondents), classes of equity such as paid-in capital, share premium, retained earnings and items of income and expense (Q24): X^2 = 37.0, p = 0.000 (76.7% of respondents), property, plant and equipment (Q19): X^2 = 27.4, p = 0.000 (69.7% of respondents) and inventories (Q21): X^2 = 20.8, p = 0.000 (58.2% of respondents) are considered to be useful for their lending decisions.

The Chi-square test results also show that there are statistically significant differences between respondents in the perceived usefulness of two disclosure items, with more bank lending officers perceiving the sub-classifications as either ‘not useful’ or ‘neutral’ and fewer bank lending officers perceiving the information as ‘useful’. The disclosure requirements of classifications for classes of share capital (Q25): X^2 = 7.6, p = 0.023 (53.5% of respondents) and provisions for employee benefits and other provisions (Q23): X^2 = 13.6, p = 0.001 (51.2% of respondents) are perceived by the majority of bank lending officers as being less useful.

These results indicate that bank lending officers agree that five out of seven of the disclosure requirements of the balance sheet sub-classifications are useful, although they are neutral about the other two sub-classifications. The Chi-square test results are reported in Table 5.7 and the percentage of frequency distribution of the responses is reported in Table 5.9.

5.4.4.2 Decision usefulness of disclosure requirements of income statement and statement of comprehensive income

Information items 26 to 39 sought to examine the usefulness of the disclosure requirements of the income statement and statement of comprehensive income. All bank lending officers agreed that revenue (Q26) is the most useful decision item in the income statement. The

Chi-square test results show that there are statistically significant differences between respondents in the perceived usefulness of other income statement disclosure items, with more bank lending officers perceiving disclosure items as ‘useful’, and fewer bank lending officers perceiving them as either ‘not useful’ or ‘neutral’. Higher perceived usefulness is found in disclosures of profit and loss (Q32): $X^2 = 39.1$, $p = 0.000$ (97.7% of respondents), finance cost (Q27): $X^2 = 31.8$, $p = 0.000$ (93% of respondents), share of the profit or loss of investments in associates (Q28): $X^2 = 53.9$, $p = 0.000$ (86% of respondents), share of profit or loss of jointly controlled entities accounted for using the equity method (Q29): $X^2 = 46.0$, $p = 0.000$ (81.4% of respondents), analysis of expenses using classification based on the nature of expenses (Q38): $X^2 = 12.3$, $p = 0.000$ (76.7% of respondents) and analysis of expenses using classification based on the function of expenses (Q39): $X^2 = 8.4$, $p = 0.004$ (72.1% of respondents). Disclosure items such as discontinued operations (Q31): $X^2 = 26.6$, $p = 0.000$ and tax expenses (Q30): $X^2 = 24.7$, $p = 0.000$ were regarded as useful by 69.8% and 67.4% of respondents, respectively.

With regard to the disclosure items in the statement of comprehensive income, total comprehensive income (Q35): $X^2 = 31.8$, $p = 0.000$ (93% of respondents) and other comprehensive income classified by nature (Q33): $X^2 = 25.3$, $p = 0.000$ (88.4% of respondents) were regarded as useful for making lending decisions by the majority of the bank lending officers. While 62.8% of respondents regarded the disclosure of other comprehensive income of associates and jointly controlled entities (Q34) as useful: $X^2 = 2.8$, $p = 0.093$, 37.2% held a neutral opinion. Disclosures of profit or loss attributable to non-controlling interest and owners of the parent (Q36): $X^2 = 17.6$, $p = 0.000$, and total comprehensive income for the period attributable to non-controlling interest and owners of the parent (Q37): $X^2 = 14.0$, $p = 0.001$ in the income statement and statement of comprehensive income were regarded as useful by only 55.8% of respondents. 44.2% of respondents considered these two information items not useful, or held a neutral opinion. The Chi-square test results are reported in Table 5.7 and the percentage of frequency distribution of the responses is reported in Table 5.10.

5.4.4.3 Decision usefulness of disclosure requirements of statement of changes in equity and retained earnings

Information items 40 to 43 sought to examine the usefulness of disclosure requirements of statements of change in equity. The Chi-square test results show that there are statistically significant differences between respondents in the perceived usefulness of disclosure items, with more bank lending officers perceiving the disclosure items as ‘useful’, and fewer bank lending officers perceiving them as either ‘not useful’ or ‘neutral’. The majority of bank lending officers agreed that disclosures of details about retained earnings at the beginning and end of the reporting period (Q43): X^2 = 41.3, p = 0.000, (79% of the respondents) and total comprehensive income for the period (Q40): X^2 = 44.7, p = 0.000 (81.4% of respondents) are useful for their lending decisions. 67.5% of respondents agreed that a reconciliation between carrying amounts at the beginning and end of the period for each equity component (Q42): X^2 = 23.1, p = 0.000 is useful. While 53.5% of respondents regarded the effects of retrospective restatement recognised for each component of equity (Q41): X^2 = 14.7, p = 0.001 as useful, 39.5% of respondents held a neutral opinion. The Chi-square test results are reported in Table 5.7 and the percentage of frequency distribution of the responses is reported in Table 5.11.

5.4.4.4 Decision usefulness of disclosure requirements of cash flow statement

Information items 44 to 52 sought to examine the usefulness of disclosure requirements of the cash flow statement. The Chi-square test results show that there are statistically significant differences between respondents in the perceived usefulness of disclosure items, with more bank lending officers perceiving the disclosure of cash flow items as ‘useful’, and fewer bank lending officers perceiving them as either ‘not useful’ or ‘neutral’. The results show that overall, 90.6% of respondents strongly agreed that cash flows for a reporting period classified by operating, investing and financing activities (Q44): X^2 = 63.7, p = 0.000 are useful for their lending decisions. The bank lending officers are strongly of the view that cash flows arising from operating activities are very useful for their lending decisions, but the majority preferred cash flows from operating activities to be disclosed using the indirect method (Q45): X^2 = 33.5, p = 0.000 (74.4% of respondents) rather than the direct method (Q46): X^2 = 24.7, p = 0.000 (67.4% of respondents). The Chi-square test results also show that 83.7% of respondents agreed that disclosures of major classes of gross cash receipts and gross cash payments arising from financing activities (Q48): X^2 = 49.2, p = 0.000 are very useful, while only 65.1% of respondents agreed that major classes of gross cash receipts and gross cash payments arising from investing activities (Q47): X^2 = 22.4, p = 0.000 are very useful. Another 27.9% of respondents held a neutral opinion on the usefulness of cash flows from investing activities.

Disclosure items such as cash flows arising from income tax (Q51) and the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the entity (Q52) were regarded as useful: X^2 = 19.9, p = 0.000 by 65.1% of respondents, while 34.9% of respondents held a not useful or neutral opinion. Only 60.5% of respondents agreed that cash flows arising from transactions in a foreign currency (Q49) are useful: X^2 = 16.0, p = 0.000, while 39.5% of the respondents held a not useful or neutral opinion. 60.5% of respondents considered cash flows from interest and dividends received and paid (Q50) as useful: X^2 = 17.1, p = 0.000, while 39.5% held a not useful or neutral opinion. The Chi-square test results are reported in Table 5.7 and the percentage of frequency distribution of the responses is reported in Table 5.12.

As discussed in Section 5.4.2, the study first requested the bank lending officers to assess the usefulness of accounting information sources for their lending decisions. Ranked by the mean values, the bank lending officers chose cash flow statement as the most useful accounting information source. However, inconsistent with this finding, the bank lending officers assigned relatively higher weight to the information items in the income statement—profit and loss (mean = 4.81) and revenue (mean = 4.74)—than to the information about cash flows classified by operating, investing and financing activities (mean = 4.47) (see Table 5.7). This inconsistency is nevertheless justified by the findings of Kwok (2002) which indicate that bank loan officers consider the cash flow statement to be a more useful information source than other financial statements, yet they sought this information from accrual-based financial statements, not necessarily from the cash flow statement. This finding is also consistent with Yap (1997), who found that accounting data such as future prospects and level of profits are regarded as being as important as cash flows in making investment and lending decisions. In some situations, it might be challenging for creditors to identify the most influential accounting information, because all types of major accounting information is considered to be important for their lending decisions.

The results also show that cash flows for a reporting period classified by operating and financing activities are significantly more important for lending decisions than cash flows classified by investing activities. Prior research has established that cash flows arising from operating activities are more important than cash flows arising from financing and investing activities (Allen & Cote, 2005). In contrast to the findings of prior research, this study reveals that bank lending officers consider cash flows arising from both operating activities and financing activities to be equally important for their lending decisions. Generally, cash flow information is an important source of information for assessing a borrower's creditworthiness (Allen & Cote, 2005). While the operating cash flow confirms positive earnings, it also provides strong indications about the future performance of the company, which is of great interest to creditors to ensure the company's repayment ability (Allen & Cote, 2005). Section 7 *Statement of Cash Flows* of IFRS for SMEs defines financing activities as "activities that result in changes in the size and composition of the contributed equity and borrowings of an entity" (IASB, 2009a, p. 37). While positive cash flows from financing activities are indicative of the company's ability to raise cash for future expansion, negative cash flows from financing activities are an indication of the use of surplus cash for the repayment of debts, etc. This information is important for bank lending officers, particularly to assess the company's liquidity position (Yap, 1997). As such, there are reasonable grounds to admit that operating and financing cash flows are equally important for bank lending decisions.

5.4.4.5 Decision usefulness of disclosure requirements of notes to the financial statement

Information items 53 to 56 sought to examine the usefulness of disclosure requirements of notes to the financial statements. The Chi-square test results show that there are statistically significant differences between respondents in the perceived usefulness of disclosure items, with more bank lending officers perceiving disclosure items as 'useful', and fewer bank lending officers perceiving those as either 'not useful' or 'neutral'. The results show that 90.7% of respondents strongly agreed ($X^2 = 28.5$, p = 0.000) that a statement indicating that the financial statements have been prepared in compliance with IFRS for SMEs (Q53) would enhance their decision usefulness. 81.4% of respondents strongly agreed ($X^2 = 17.0$, p = 0.000) that the judgments that management has made in the process of applying accounting policies (Q55) are useful. Further, 79.1% of respondents agreed ($X^2 = 14.5$, p

= 0.000) that the key assumptions made by the management (Q56) are useful, whereas a summary of the significant accounting policies applied (Q54) was also rated as useful (X^2 = 8.4, p = 0.004) by 72.1% of respondents. The Chi-square test results are reported in Table 5.7 and the percentage of frequency distribution of the responses is reported in Table 5.13.

Quantitative data analysis of the first part of the study indicates that most of the accounting disclosure items in IFRS for SMEs appear to be useful for the lending decisions of SMEs. Accordingly, it can be concluded that the development of IFRS for SMEs pertaining to the disclosure requirements is particularly responsive to the information needs of bank lending officers. Explanations of why certain accounting disclosure items were regarded as useful or less useful were traced in the interviews. The survey questionnaire investigated the usefulness of the accounting disclosure items of IFRS for SMEs, and the triangulation of these results with data collected from the interviews with bank lending officers allowed to carry out an in-depth analysis of the usefulness of the information provided by financial reports prepared in accordance with IFRS for SMEs.

5.5 RESULTS AND DISCUSSION – THE SEMI-STRUCTURED INTERVIEWS

5.5.1 Demographic details of the interviewees

As mentioned earlier, 19 interviews were conducted in total with senior bank lending officers, representing the four major LCBs in Sri Lanka. As shown in Table 5.2, 14 of the 19 participants were male and five were female. The mean age of the respondents was 42 years. The average number of years of formal education was 17 years. Of the 19 participants, 16 were qualified members of the Institute of Bankers of Sri Lanka (IBSL); ten held a Diploma in Banking & Finance qualification and six held a Certificate in Banking & Finance qualification. Three of the participants also held professional accounting qualifications (Certified Institute of Management Accountants – CIMA qualification) and four participants held a Master of Business Administration (MBA) degree. The participants had an average of 9.31 years of work experience in SME lending, and were generally familiar with the Sri Lankan equivalents of IFRS for SMEs, as indicated by the mean response of 3.47. The interviewees' profiles are reported in Table 5.14.

5.5.2 Perception of bank lending officers on the usefulness of simplified recognition and measurement requirements of IFRS for SMEs on lending decisions

The second objective of this study was to assess the opinion of bank lending officers on the usefulness of the simplified recognition and measurement requirements of IFRS for SMEs on their SME lending decisions. As mentioned earlier, the semi-structured interviews were based on three key themes to ascertain the perceptions of bank lending officers on the usefulness of (1) the simplified measurement and recognition requirements of IFRS for SMEs, (2) accounting information on SME lending decisions, and (3) financial statements prepared in compliance with IFRS for SMEs

The questions targeting the perceptions of the simplified measurement and recognition requirements of IFRS for SMEs focused on the prohibition of the revaluation policy option on property, plant and equipment; the recognition of research and development costs as expenses when incurred; the usefulness of fair values for certain asset classes such as investments in associates, investments in jointly controlled entities; and recognition of deferred tax accounting. Interviewees were asked to comment on the appropriateness and economic consequences of the simplification of recognition and measurement requirements on their lending decisions.[51]

NVivo 10 software was used for coding and analysing the transcribed interviews. The coding process was initiated with the key themes developed and three main nodes were constructed. An in-depth inductive sub-coding process was then employed to further expose and identify the patterns or themes evolving under each main node. This coding process helped with summarising the meaning (rather than the keywords) of each piece of information conveyed by the transcribed data (Miles, Huberman, & Saldaña, 2013; Son et al., 2006; Sormunen, 2014), and constructing a thematic node hierarchy (Appendix 6). This

[51] The IASB has made a limited number of amendments to IFRS for SMEs following the completion of the initial comprehensive review in May 2015. For example, the standard now permits SMEs to use the revaluation policy option for property, plant and equipment, and has aligned the main recognition and measurement requirements for deferred tax with full IFRS with effect from the annual period beginning on or after 1 January 2017 (IFRS Foundation, 2015a). As this study was conducted prior to these proposed amendments, the perceptions of the bank lending officers on these issues were also sought.

thematic node hierarchy is a hierarchical structure that integrates the main nodes and all the sub-nodes (theme nodes) constructed in the inductive coding process.

Analytical techniques such as framework matrices were used to summarise the coded data in a grid format (where rows represent case nodes and columns represent theme nodes) (QSR International, 2014). Each cell was inspected carefully to identify the interactions of cases and themes. Tree maps of nodes were created where necessary to compare the number of coding references.[52] A detailed analysis and interpretation of the themes arising from the coding process are discussed in the following section.

5.5.2.1 Revaluation of property, plant and equipment

A major simplification in IFRS for SMEs is the omission of the revaluation policy option from Section 17 *Property, Plant and Equipment*. Without this ability to revalue property, plant and equipment (PPE), all PPE must be measured "at cost less any accumulated depreciation and any accumulated impairment losses" (cost model) (IASB, 2009a, p. 94). The revaluation of PPE has been regarded as "one of the complex accounting policy options in full IFRS" (IFRS Foundation, 2012d, p. 22) and the IASB believes that the objectives of comparability and simplification of IFRS for SMEs can be achieved with the elimination of this revaluation option (IASB, 2009b).

Despite the omission of the revaluation policy option, revaluation of PPE has been a common practice among listed and non-listed entities in many jurisdictions (ACCA, 2012). The opinions expressed by bank lending officers indicate that recognition and measurement principles should be the same across all entities, regardless of the size and listed nature of the entities. Notably, the bank lending officers had limited awareness of the divergence in some recognition and measurement principles in IFRS for SMEs. For example, one interviewee commented that:

> Actually I came across this once and I got confused. I did not know that it is been treated in two different ways. I came to know that SMEs do not recognise revaluation values in their

[52] A tree map is a diagrammatic analytical tool in NVivo 10 which shows the hierarchical data as a set of nested rectangles of varying sizes (QSR International, 2014). A node with a higher number of coding references is symbolised by a large rectangle, and a node with a smaller number of coding references is symbolised by a small rectangle.

> financial statements. I was then thinking why should there not be one standard for everybody? This divergence may complicate our evaluations. (Interviewee 17, p. 3)

Nevertheless, bank lending officers prefer PPE to be measured at fair values, for instance where assets are pledged as security for collateral purposes. Bank lending officers explained their preference as follows:

> If the company is required to pledge certain assets/properties, then a valuation conducted showing the present value would definitely be required for our lending decisions. (Interviewee 12, p. 3)

This was also evidenced by the bank lending officers' responses to the questionnaire survey, since they held a neutral opinion on the usefulness of information about PPE measured at historical cost for their lending decisions. However, discussions with bank lending officers also revealed that even though they prefer PPE to be measured at fair values, banks do not necessarily rely on the valuation figures reported by clients. It is a common practice in the banking industry that the assets to be pledged have to be valued by panel valuers at the bank level. This was confirmed by many interviewees, who said:

> …even if the revaluations are recognised in the Profit and Loss statement, we do an independent valuation. We do not normally rely on the valuation that is being placed on the accounts. We have our own panel of valuers. We do it on our own. (Interviewee 15, p. 3)

However, the bank lending officers revealed that the cost of valuation has to be met by the customer. For example, one interviewee commented that:

> The customer has to bear the cost of valuation. It is an additional cost for the customer. Because we charge it to the customer. (Interviewee 15, p. 3)

If SME clients are required to bear the associated cost of valuation, the complexity associated with measuring the fair values of assets will be reduced but the costs associated with valuations will increase, resulting in a trade-off between costs and benefits.

In contrast to the cost model proposed in IFRS for SMEs, the IAS 16 *Property, Plant and Equipment* in full IFRS permits entities to opt for a revaluation model for all its PPE classes. As prescribed by IAS 16, "after recognition as an asset, an item of PPE whose fair value can be measured reliably is carried at a revalued amount—its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses" (IFRS Foundation, 2014c, p. 889).

IAS 16 indicates that "if the carrying amount is increased as a result of a revaluation, the increases have to be recognised in other comprehensive income and accumulated in equity under the heading of *revaluation surplus*" (IFRS Foundation, 2014c, p. 891), unless an increase reverses a previous revaluation decrease recognised in profit or loss for the same asset (IFRS Foundation, 2012d, p. 22). Revaluation decreases that are in excess of prior increases are recognised in profit or loss. The IFRS Foundation (2012) further specifies that revaluations must be made with sufficient regularity to ensure that the carrying amount does not differ materially from the amount that would be determined using fair value at the end of the reporting period (p. 22). As such, bank lending officers are of the view that a substantial enhancement in revaluations would embellish the books of SMEs by making the earnings appear to be more attractive than they are. As the present values are clearly higher than the historical cost, bank lending officers consider historical cost to be more prudent than the revalued value of assets. Taking these facts into consideration, the omission of a revaluation option from IFRS for SMEs appears to be attractive for bank loan evaluations, as illustrated by the following quote:

> Our decision is based more on profit and loss that is justified by cash flows. Revaluation will not bring in cash flows. So even in the earlier system, we would discount a profit and loss that has been overstated by revaluations. So therefore, this new principle works fine by bankers because we are looking at hard cash available at the end of the day for re-payment. (Interviewee 5, p. 3)

In summary, the decision usefulness of the measurement of PPE on bank lending decisions can be established in the following way. As mentioned previously, the primary concern of lending is to ensure the borrower's ability to repay the loan. Therefore, assessment of the creditworthiness of the borrower is of utmost importance. The findings of this study reveal that profit and loss information, justified by cash flows, is the primary concern of bank lending officers thus, recognition of PPE on historical cost basis would better serve the bank's need to assess a borrower's repayment ability. On the other hand, details of PPE measured at fair value are required to secure the loan repayment (to dilute the bank's risk) in the event that a borrower were to incur unforeseen events that would hinder their ability to repay the loan.

The IASB asserts that the degree of difference between full IFRS and IFRS for SMEs must be determined on the basis of user need and cost-benefit considerations. In conclusion, as stressed by the IASB, if the simplification of IFRS for SMEs is determined on the basis of the banks' needs, then PPE measured on a historical cost basis is justifiable.

Another simplification associated with PPE is that IFRS for SMEs do not require an annual review of the useful life, residual value, and depreciation or amortisation method for property, plant and equipment and intangible assets. Instead, a review is required only if there is an indication of significant change since the last annual reporting date. IAS 16 and IAS 38 *Intangible Assets* require reviews at least at each financial year-end (IASB, 2009a, p. 44). Discussions with bank lending officers revealed that the general rule of thumb used by the licensed commercial banks (LCBs) is that property, plant and equipment held by an SME must be valued at least every fourth year (Interviewee 17, p. 3). This simplification appears to have no impact on disclosure, and the simplification is therefore justified.

5.5.2.2 Capitalisation of development costs

IFRS for SMEs require that all research and development costs be charged "to expense when it is incurred unless it forms part of the cost of another asset that meets the recognition criteria in IFRS for SMEs" (IASB, 2009a, p. 100). Difficulty in measuring the commercial viability of the project due to a lack of resources has been regarded as the key reason for proposing this simplification (IFRS Foundation, 2012d). According to the criteria prescribed by IAS 38 *Intangible Assets* in full IFRS, all research costs and some development costs must be charged to expense. If the entity is able to demonstrate that the development has produced an asset with future economic benefits, then the development cost must be capitalised (IFRS Foundation, 2014c).

The interviewees held multiple views about the capitalisation of development cost. Many bank lending officers were of the view that information about capitalised development costs was insignificant and added little value; they therefore ignored such costs when making their lending decisions. For example, one lending officer mentioned that:

> Actually, we will not go down cost by cost, administration or marketing, etc. If there were a higher variation, we would then go cost by cost, but we would not go to see whether research and development cost has been accrued into or not and that is up to them. We would see how the business progresses. (Interviewee 6, p. 4)

A number of bank lending officers critiqued the IASB's initiative due to the fact that development costs as a substantial element for many SMEs would have a major impact on their financial statements, especially for newly created business ventures in the phase of development and research for new products and markets. By charging the research and development cost to the profit and loss account as an expense, the true position of the company could be significantly falsified by the current requirement of IFRS for SMEs. In contrast to this view, one lending officer indicated that this approach is better for the banks:

> If the company has incurred research and development cost, it has to be shown in the profit and loss account as an expense. If it is a cash outflow, it impacts the loan re-payment capacity of the client. Therefore, we would, as bankers, prefer it in this way. (Interviewee 5, p. 4)

Despite this inconsistency in the views on research and development costs to be charged as expense, the majority of interviewees held the view that information such as research and development costs adds little or no value to their lending decisions. However, the findings do not justify the assertion that research and development cost has to be expensed, thus this simplification could not be justified on the basis of user need.

5.5.2.3 Accounting for deferred income tax

Section 29 *Income Tax* of IFRS for SMEs requires that deferred income tax has to be recognised using the temporary difference method (IFRS Foundation, 2012d).[53] This

[53] The temporary difference method bases deferred taxes on the difference between the tax basis of an asset or liability and its carrying amount (IASB, 2009a; IFRS Foundation, 2012d).

requirement was debated extensively and accounting regulatory bodies and institutions from different jurisdictions hold different views about this recognition. A number of regulators are in favour of this requirement and assert that SMEs should recognise deferred income taxes, and judge that the temporary difference method is appropriate, while several hold the view that the application of the temporary difference method is too complex for SMEs and propose that the temporary difference method should be replaced with the timing difference method.[54] Others hold the view that "SMEs should recognise deferred taxes only for timing differences" (IFRS Foundation, 2012d, pp. 27-28), which is also called the 'liability method'. There are some regulators who hold the view that "SMEs should not recognise any deferred taxes at all" (IFRS Foundation, 2012d, p. 28), which is also called the 'tax payable method'.

Although disagreements exist among the regulators and accounting institutions with regard to the appropriate method of recognising deferred income taxes, it is apparent that there is a lack of interest among bank lending officers in deferred tax disclosures by SMEs for loan evaluation decisions.

> I think it is important, but again, we will not place too much emphasis on that area, if the risk grading and the acceptability of that company is OK for us. (Interviewee 19, p. 6)

Some bank lending officers were of the view that the emphasis applied to deferred tax information would vary depending on the nature of the business and size of SMEs.

> The weight we would give to this type of information will vary depending on the nature of their business. For very small entities, we do not give much weight for this information. But for SMEs on a large scale, we assign a good weight for deferred tax accounting information. (Interviewee 2, p. 4)

Indeed, the opinions of bank lending officers also indicate that the taxes payable method would be reasonable if the expected effective tax rates were disclosed. One lending officer described his opinion as follows:

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[54] The timing difference method bases deferred taxes on the difference between when an item of income or expense is recognised for tax purposes and when it is recognised in profit or loss (IASB, 2009a; IFRS Foundation, 2012d).

> One key thing would be, that in a position of their hierarchy of payments that need to go out, tax is one of the first items that they need to pay out. Having information on their liabilities on deferred tax is quite important because even though they may have cash, that cash may be required to settle other liabilities before they can settle any other bank liabilities. So, that is a key ingredient but it is not one of the most key ingredients that we will look at. It is a secondary thing that we will look at. (Interviewee 5, p. 4)

Even though some interviewees were in favour of deferred tax accounting disclosures, the majority of interviewees held the view that this information fails to provide much assistance for their lending decisions. Therefore, the recognition method of deferred tax is not very important to them.

5.5.2.4 Fair value measurements in financial and non-financial assets

Section 14 *Investments in Associates* of IFRS for SMEs specifies that an investor (SME) has an accounting policy choice in its consolidated financial statements to account for investments in associates and jointly controlled entities using (1) the cost model, (2) the equity method, or (3) the fair value model (IASB, 2009a). In respect to investments for which a market price is available, “the standard is unclear as to whether measurement at fair value through profit or loss is mandatory, irrespective of the SME’s accounting choice for investees or only if the cost model is chosen” (KPMG, 2010, p. 14).

The bank lending officers indicated that the decision usefulness of the fair value measurement concept varies between different asset classes. In particular, the bank lending officers who take interest in certain asset classes, such as non-financial assets—investments in associates and jointly controlled entities—generally rate fair values as the most decision useful measurement concept. The discussions with interviewees revealed that they preferred investments to be measured at mark-to-market fair values, as reflected by the following quote:

> For investments, especially those that are quoted investments, the fair value method is appropriate. If it is mark-to-market for quoted investments, we know that there is a certain price that is available today. So, in this sense, mark-to-market value, especially for those items, would be better for the purpose of lending because we would know what the market would be willing to pay for that asset now. Whereas if fair value is a judgment call made by the directors,

> it is not dependent on mark-to-market or on market conditions; it is only an opinion of some people for lending purposes. Mark-to-market is what we would look for, if possible. (Interviewee 5, p. 4)

Several bank lending officers pointed out that most SMEs do not have investments in associates and that fair value measurements are fairly important with regard to investments in financial instruments.

> Fair values of the companies which I am handling have financial investments. In such cases, fair value is fairly important. But many of the companies do not have any associates. Also, in that respect, fair value is important in terms of financial investments mainly. (Interviewee 17, p. 3)

A number of bank lending officers revealed that the importance of fair value measurements varies depending on the size and scale of their lending: “We do consider fair value as important, especially for medium and large-scale lending” (Interviewee 1, p. 3).

The opinions expressed by the bank lending officers suggest that although they believe fair value to be useful for their lending decisions, they are concerned about how fair value is determined. That is, they distinguish between the concepts of mark-to-market fair values and judgment-based fair values, especially when companies employ models to determine fair value in the absence of existing market prices. This finding is consistent with Gassen and Schwedler (2010), who found that professional investors and advisors consider mark-to-market fair values to be more decision useful than mark-to-model fair values. This is because mark-to-market fair values are based on current market prices or similar assets and liabilities, which are considered to be more reliable than subjective judgment-based models (PWC, 2008). Therefore, it is apparent that bank lending officers are more confident with mark-to-market fair values for their lending decisions. As such, disclosures of fair values signal the impact of market liquidity on the company, which is useful for the decision makers.

5.5.2.5 The perception of bank lending officers on the impact of topics omitted from IFRS for SMEs on their lending decisions

IFRS for SMEs do not address the presentation of earnings per share, interim financial reporting, and segment reporting (IASB, 2009b). This study is also interested in investigating the opinions of bank lending officers on whether the absence of this information has an impact on their lending decisions. The discussions with bank lending officers revealed that information about earnings per share and segment reporting adds no value to their lending decisions and the IASB's initiative to detach these topics from IFRS for SMEs is justified. For an example, a lending officer stated:

> We would look at earnings per share only if we are looking at the value of the company. It is not something very important for our decisions unless we are doing something like an acquisition or a merger, where the value of the share is the key factor. (Interviewee 5, p. 5)

The discussions with bank lending officers further revealed that while they do consider interim reporting to be useful, the absence of an IFRS requirement for interim reporting does not necessarily impact their lending decisions. Unlike investors, who cannot usually request information directly from firms, banks as users of financial statements have the ability to request the additional information they need from their clients to make their lending decisions. Bank lending officers revealed that banks usually request interim financial statements—the management accounts—in audited format, but not necessarily the audited interim reports. In the banking industry, the term 'management accounts' refers to the accounts prepared by the company for management purposes.

> If it is a listed company, definitely we will look at their financials each quarter. Even for non-listed companies, we would ask them to submit management accounts at least every half-year. So, even though it may not be an IFRS requirement, we would definitely ask them to submit it to us. To help our decisions, we want information which is as current as possible. For example, if we are lending in December, we would not look at just the March figures, we would also look at the September figures. (Interviewee 5, p. 5)

Interim financial statements do not usually have to be audited; however, there are some instances in which a bank definitely requires audited interim financial statements. In this respect, bank lending officers are concerned about the discontinuation of the interim reporting requirement by IFRS for SMEs.

> For some clients, we might ask for quarterly audited financials. If a client encounters financial difficulties with negative net worth and declining turnover, in such situations, we might call for regular management accounts but for some specific occasions, we might call for audited interim financials as well. In addition, we might need to call for audited interims if a new customer comes to us for a facility in between a financial period, so we might need to get an interim account audited to get the latest financial position, the latest available. In such instances, there might be an impact on the discontinuation of interim reporting. (Interviewee 17, p. 3)

Discussions with the interviewees revealed that for most clients, it is a constitutional requirement of the bank's letter of offer (or the lender's agreement) to submit interim financial reports (usually quarterly financial statements).

5.5.3 Additional analysis

During the interviews, bank lending officers were asked to indicate their general perception of the role of accounting information on SME lending decisions, and their overall perception of the usefulness of financial statements prepared in compliance with IFRS for SMEs.

5.5.3.1 Role of accounting information on SME lending

In the current lending environment, banks are experiencing difficulties in collecting accurate financial information that portrays a true picture of a business. The discussions with interviewees revealed that the formation and adoption of IFRS for SMEs enables bank lending officers to access accurate accounting information with more ease than was previously possible. Bank lending officers are of the view that if SMEs follow common accounting and reporting rules that define how business transactions should be recorded and reported, and what information a company should disclose in its financial statements, comparability will be enhanced. A number of bank lending officers revealed that their credit score-based evaluation process would be easier to apply and rationalise, and the formation of industry benchmarks for evaluations would be possible, if all SMEs were to prepare their financial statements in a uniform manner. For example, a lending officer cited that:

> The new standards are streamlined. So, if all companies prepare their financial statements according to these standards, we know that we are evaluating apples with apples. If they use different policies or a different set of standards, comparisons between the companies would not be possible. But if every company is reporting in a uniform way, we can establish some industry benchmarks for certain ratios and it would be the same for everyone. So having a uniform procedure is very important. (Interviewee 5, p. 2)

Most commercial banks have recently developed rating systems to determine the creditworthiness of a borrower and the credit risk (Blöchlinger & Leippold, 2006). Under this system, a credit score is produced for the prospective borrower, who is ranked accordingly. Bank lending officers commented that this is the main metric used by the banks to determine whether a borrower is worthy of a favourable rate. Both financial and non-financial information is fed into this system to derive this metric. The system weights five characteristics of the borrower (i.e. character, capacity, capital, collateral and condition—most commonly referred to as the Five Cs) and attempts to gauge the likelihood of default. For example, Interviewee 11 revealed that in their credit rating evaluation process, the bank assigns a weight of 40% for management character, 20% for financial capacity, 20% for business risk (market share, competition), and 20% for industry condition (impact of government policies, technological dependency, environmental effects[55], infrastructure facilities, etc.).

Accounting information is mostly used for measuring the financial capacity of the borrower. A weighted average ratio is calculated based on such ratios as weighted average sales growth, average net profit, average debt service cover, current ratio, weighted average operating cash flows, gearing, and financial risk. The availability of assets and extent of liabilities is also considered to determine the probability of default. A weight will also be assigned to accounting quality (measured by the reliability of the financial statements).

[55] With sustainability practices coming into effect, banks prefer to lend for environmentally responsible projects.

The reliability of an audited financial statement is considered to be high, whereas the reliability of a draft report is considered to be low.

If financial statements are presented in a uniform manner in accordance with IFRS for SMEs, the information provided will supplement the information needs of banks. However, the discussions revealed that banks also need other financial information that is not ordinarily presented in financial statements; for example, information such as financial information forecasts—that is, an extrapolation of the existing financials to what companies believe they will achieve in the next three to five years. Income statement and cash flow projections are also important for their lending decisions, and banks may also request an age analysis of the debtors, or an age analysis of inventories for situations in which debtors or inventories are used as collateral (Interviewee 15, p. 2).

Bank lending officers nevertheless revealed that the intensive competition between commercial banks drives commercial lending to be extremely competitive. As such, if companies are required to disclose information that is too costly to provide, clients may seek other lending sources or a more competitive bank. Because of this information cost, bank lending officers are sometimes reluctant to request greater disclosure. Even if a client is unable to provide a complete set of financial reports, they would still be entitled to the grant of a loan if their creditworthiness can be proven by sources of information other than financials. As long as they are confident of the client's capacity to repay and the bank's ability to recover the loans granted, banks are unconcerned about every piece of information in SME financial statements.

5.5.3.2 Overall perception of bank lending officers on the usefulness of financial statements prepared in compliance with IFRS for SMEs

The IASB warrants that SMEs will benefit from preparing financial statements using a common set of accounting standards and makes a claim that "bankers rely on financial statements in making lending decisions and in establishing terms and interest rates" (IASB, 2009b, p. 16). During the interviews, bank lending officers expressed their opinions on whether a complete set of financial statements prepared in compliance with IFRS for SMEs helps to lower a borrower's cost of capital. The majority held the view that their current lending decisions were not purely financial information-oriented. As such, pricing was not merely driven by the financial standing of the borrower, but was instead more relationship-oriented. For example, one interviewee expressed the view that:

> Well ideally it should. If the financial position of a customer is satisfactory, we charge a low risk premium. Right now, there is no risk-based pricing system in place, but it is more on relationship-based I suppose. There is certain weightage given to lowering of the risk by having good financials. But it is not a key criterion in deciding on the pricing. (Interviewee 5, p. 3)

The findings of this analysis can be combined with prior research which shows that bank loan officers are oriented towards 'relationship lending practices' (Boot, 2000; Trönnberg & Hemlin, 2014) and 'transactional lending practices' (Thomas, 2000; Trönnberg & Hemlin, 2014). While relationship lending focuses more on the personal relationship between the loan officer and the loan applicant (which some researchers defined as non-financial information or soft information) (Uchida, Udell, & Yamori, 2012), transactional lending is based more on the financial information of the company (also defined as hard information) (Uchida et al., 2012). The findings of prior research stress that both of these lending practices influence the assessment of a borrower's creditworthiness (Trönnberg & Hemlin, 2014). However, the findings of this study indicate that financial information is directly associated with assessing the creditworthiness of a borrower and thereby lowering risk, while the relationship with the bank or bank lending officers is highly influential in the pricing decision.

The bank's required margin and market competition and the customer's background (e.g. caliber of the customer, length of acquaintance) and bargaining power, as well as the prevailing market interest rate, are at the top of the hierarchy in relation to the establishment of interest rates. However, the bargaining power of the customer also depends on the customer's financial viability. Customers with high bargaining power, in particular, might put relentless pressure on a bank to lower the interest rate. Bank lending officers expressed the view that accounting standards might strengthen a customer's financial standing, and in that sense, accounting standards might be an advantage for obtaining a better interest rate. However, as noted by Baker and Cunningham (1993), the interest rate is not a function of the basis on which accounts are prepared. For example, a credit officer expressed his opinion that:

> I believe that if financial statements are prepared in a way that strength is reflected this may be in compliance with IFRS and is a bit of an advantage for obtaining a fair price. But it depends more on how strong the customer is and how great is the fear that a competitor may grab our customers. The strength may be reflected in proper financials. (Interviewee 18, p. 3)

However, the extent to which financial statements prepared in compliance with accounting standards contribute to the determination of loan pricing is not clear from the discussions.

5.5.3.3 Audited financial statements and IFRS for SMEs

This study also sought to determine the general perception of bank lending officers on audited financial statements as well as the impact of 'compliance' with IFRS for SMEs on bank lending decisions. Prior research demonstrates that the accounting information in financial statements is more reliable when it is prepared in compliance with accounting standards or GAAP and audited (Abu-Nassar & Rutherford, 1996; Baker & Cunningham, 1993; Gómez-Guillamón, 2003; Kent & Munro, 1999; Kitindi et al., 2007). In line with the findings of prior studies, bank lending officers expressed their opinion that audited reports enhanced the reliability of the financial information provided by clients. Most of them preferred the financial statements to be audited by reputable audit firms. Further, most bank lending officers stressed that producing audited financial statements is essential, especially for medium and large scale SME lending.

> Definitely our reliability goes up with the audited financial statements. We, in fact, insist that all our clients provide audited financials within 6 months of the closure of the financial year. (Interviewee 5, p. 2)

Audited financial accounting information represents a fundamental source of credible information, therefore bank lending officers assign a good weight to audited financial statements in their credit scoring systems and customers are advantaged by producing audited financial statements. For example, a credit officer cited that:

> Definitely, we give priority when it is audited. Our assessments are based on a credit score system. We will assign a higher value if the financial reports are audited. (Interviewee 3, p. 2)

However, bank lending officers also explained that customers are not penalised for not producing audited financial statements. Some customers (small scale SMEs in particular) produce management accounts, accounts prepared for tax purposes, or draft accounts. In such cases, bank lending officers request additional information from their clients. The additional information is mostly non-financial information to establish the credibility/trustworthiness of the borrower, such as guarantees, security, etc. This finding conforms with the observations of Kent and Munro (1999).

Bank lending officers expressed their opinion on the usefulness of SME financial reports that are prepared in compliance with IFRS for SMEs. Loan officers emphasised that their confidence is increased when financial statements are prepared in accordance with accounting standards (i.e. IFRS for SMEs).

The bank lending officers also agreed that SME financial information is more reliable if it is prepared in accordance with the criteria prescribed by IFRS for SMEs. However, they are of the view that deviation by an SME client from IFRS for SMEs, or the accounting standards they otherwise apply, does not necessarily affect a bank lending officer's assessment of the borrower's repayment ability or the creditworthiness of the client. In particular, bank lending officers do not distinguish between audited reports and reports prepared in compliance with IFRS for SMEs, but they are more confident in having audited reports in general to make their decisions. For example, a lending officer expressed the opinion that:

> I do not particularly consider compliance with accounting standards because I am sure that the auditors will do their job according to the guidelines prescribed by the accounting standards. (Interviewee 5, p. 2)

Overall, the findings from the additional analysis reveal that in assessing the creditworthiness of a borrower, banks assign a high value through the credit scoring system to financial statements that have been audited, which improves the credit score of an SME. However, under their present credit scoring system, banks do not assign a specific value for compliance with the accounting standards.

5.6 SUMMARY AND CONCLUSIONS

The aim of this study has been to understand the perception of users on the decision usefulness of financial statements prepared in compliance with IFRS for SMEs. The empirical analysis was based on a questionnaire survey and follow-up interviews carried out with the senior lending officers of commercial banks. The decision usefulness of IFRS for SMEs was evaluated from two aspects of the standard: the decision usefulness of the reduced disclosure requirements of IFRS for SMEs, and the decision usefulness of the simplified recognition and measurement requirements of IFRS for SMEs.

The results show that most of the disclosure requirements of IFRS for SMEs are found to be useful for lending decisions. However, bank lending officers did not consider all disclosure requirements presented to them as equally important for their lending decisions. Information items that could help to establish a borrower’s repayment ability and secure the repayment of a loan, and items that support risk assessment, were regarded as being most useful. The primary concern of a creditor is to accurately assess a borrower’s creditworthiness or repayment ability. As such, most of the income statement disclosure items such as revenue, and profit and loss justified by cash flow were regarded as being very useful for making lending decisions. The results revealed that bank lending officers do not consider information from a comprehensive income statement to be very useful for their lending decisions. In consolidated financial statements especially, information about profit or loss and comprehensive income attributable to non-controlling interest and the owners of the parent company were regarded as being less useful.

The results reveal that bank lending officers consider that the cash flow generated by both operating activities and financing activities are equally important for their lending decisions. Operating cash flow information is useful for assessing a borrower’s repayment ability, while financing cash flow information is important for assessing a company’s liquidity position. Additionally, bank lending officers prefer cash flow from operating activities to be disclosed using the indirect method rather than the direct method.

The details of assets and liabilities presented in the statement of financial position (balance sheet) were regarded as being important only for certain classes of assets and liabilities. Information about assets and liabilities, such as trade and other receivables/payables, financial assets/liabilities, cash and cash equivalents and inventories, were regarded as very useful for lending decisions. This information is important for the banks to enable them to identify the liquidity position of a company by comparing short term assets and short term liabilities. However, information about property, plant and equipment measured at historical cost was found to be moderately useful for their lending decisions. Tax-related information, such as deferred tax assets and liabilities, and liabilities and assets for current tax were regarded as less useful. Importantly, most of the bank lending officers held a neutral opinion of the usefulness of information concerning biological assets. Certain disclosure requirements that come under the statement of changes in equity were also considered to be moderately useful.

The results reveal that bank lending officers are familiar with fair value and historical cost measurement concepts. With regard to the simplification of the measurement of property, plant and equipment, bank lending officers are optimistic about the withdrawal of the revaluation option, especially with regard to their assessments of a borrower’s repayment ability. However, bank lending officers consider PPE measured at fair value to be important for securing loan repayment. Bank lending officers who take an interest in certain asset classes such as non-financial assets—investments in associates and jointly controlled entities—generally rate fair values as the most useful measurement concept. Moreover, the findings reveal that bankers distinguish between the concepts of mark-to-market fair values and judgment-based fair values, especially when companies employ models to determine fair value in the absence of existing market prices. The results show that mark-to-market fair values are more useful than judgment-based fair values.

Bank lending officers hold a neutral opinion of the decision usefulness of simplification in the recognition of the development cost component, because bank lending officers view that information such as research and development cost adds little or no value to their lending decisions. They also demonstrate a lack of interest in deferred tax disclosures and their recognition; however, they view the taxes payable method as more reasonable than the temporary difference and timing difference methods in the recognition of deferred tax.

On the topics omitted from IFRS for SMEs, bank lending officers agreed that information such as earnings per share and segment reporting provide no useful information for their lending decisions. However, the results show that the discontinuation of interim reporting may have an impact on the lending decisions of banks. It is a constitutional requirement of most banks to require their clients to submit interim reports.

The findings suggest that bank lending officers prefer recognition and measurement principles to be the same across all entities, regardless of the size and listed nature of the entities, to minimise confusion and increase comparability across all entities. When the proposed amendments in IFRS for SMEs become effective in January 2017, it can be expected that some of the confusion that has been caused by the withdrawal of the revaluation option for PPE, recognition of deferred tax and so on will be minimised.

Overall, the findings indicate that the reduced disclosure requirements of IFRS for SMEs are useful for bank lending decisions. In particular, the disclosures that are used to generate credit scoring for evaluating the credit risk and the creditworthiness of a borrower are regarded as being the most decision-useful. Bank lending officers do not see any major issues with the simplification of the recognition and measurement requirements of IFRS for SMEs. This is because, generally speaking, banks are in a position to demand the information they need. The findings suggest that bank lending officers have limited interest in information such as the accounting basis on which the financial statements are prepared. With IFRS for SMEs being a new standard, banks have limited awareness or experience of the application of these standards by SMEs. However, as IFRS for SMEs are applied extensively by SMEs, bank lending officers believe that the adoption of IFRS for SMEs will enable banks to access accurate and comparable accounting information with greater ease, and that this will improve the efficiency of their lending processes.

By providing empirical evidence from a country that has adopted IFRS for SMEs, the findings of this study give rich and deep insights into the decision usefulness of IFRS for SMEs. The IASB received no comment letters from users of financial statements during the initial comprehensive review process of IFRS for SMEs, and as such, the IASB was unable to acquire information about the perceptions of the users on the proposed amendments to IFRS for SMEs (IFRS Foundation, 2015c). The findings of this study will be of particular interest to accounting regulators, including the IASB, for evaluating the successful implementation of IFRS for SMEs and in planning the next review of IFRS for SMEs. The IASB and SME Implementation Group (SMEIG) are presently considering ways to increase user involvement for the next review of IFRS for SMEs, and the findings of this study signify the need for user involvement in the standard setting process, particularly when future amendments are made to the standard.

The findings of this study also encourage the accounting regulatory bodies and accounting professionals at individual jurisdiction level to enhance public awareness of the simplified IFRS for SMEs, particularly among different user groups of SME financial statements. The findings will also be useful for the preparers of SME financial statements. Understanding the information needs of bank lending officers and the extent to which they rely on the accounting information produced by SMEs is important to the preparers of SME financial statements wanting to increase their access to external funds. The existing accounting literature calls for more research attention to be focused on the information needs of the users of SME financial statements. As such, the findings of this study will help to fill a gap in the existing accounting literature.

The scope of this study is limited to one user group of SME financial statements—bank lending officers. To broaden the findings of this study, future research could empirically explore the perceptions of other stakeholders, such as creditors and tax authorities, on the decision usefulness of IFRS for SMEs. The sample size used in questionnaire survey was relatively small. For this reason, the study limits the generalizability of the findings. It is important to note that the semi-structured interviews were mainly based on a number of major issues raised during the initial comprehensive review of the simplified recognition and measurement requirements of IFRS for SMEs. The IASB is still uncertain about whether to incorporate recent changes in consolidated financial statements, business combinations, and employee benefits of full IFRS to reflect the information needs of users of SMEs, but these issues have not been addressed in the current study. Future studies could usefully explore these issues to broaden the understanding of user perceptions of the simplification of IFRS for SMEs. Further research could also explore how the accounting information needs of bank lending officers vary between SMEs and public companies by taking into account the divergence between IFRS for SMEs and full IFRS.

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Table 5.1: Classification of accounting information items

Category	Number of information items
Statement of Financial Position (Balance Sheet)	18
Sub-Classification of the items disclosed in the Statement of Financial Position (Balance Sheet) or in the Notes	7
Income Statement and Statement of Comprehensive Income	14
Statement of Changes in Equity and Statement of Income & Retained Earnings	4
Statement of Cash Flows	9
Notes to the Financial Statements	4
Total	56

Table 5.2: Demographic data of the respondents

Demographic Data	Survey Group		Interview Group	
Sample Size	43		19	
Gender	Male	Female	Male	Female
	29	14	14	5
Age (Mean)	37		42	
Level of formal education in years (Mean)	17		17	
Level of experience in SME lending in years (Mean)	8.65		9.31	
Level of familiarity with the Sri Lankan equivalents of IFRS for SMEs (Mean)	3.40		3.47	

Table 5.3: Bank lending officers' approach for evaluating SME loan applications

Variable	Mean	SD
My lending decision is based on first-hand information and impression of management quality	3.47	0.984
My lending decision is based on accounting information of the company	3.60	0.979
My lending decision is based on non-accounting information of the company	3.53	1.008
My method of analysis differs according to the respective client/company	3.93	0.961

Table 5.4: Bank lending officers' opinion on the usefulness of information sources

Variable	Mean	SD
General information about the client and business	4.58	0.663
Income Statement	4.56	0.734
Balance Sheet	4.51	0.736
Cash Flow Statement	4.88	0.587
Statement of Changes in Equity and Income & Retained Earnings	4.26	0.693
Statement of Accounting Policies	3.51	0.883
Related Party Disclosures	3.67	0.778
Notes to the Annual Financial Statements	4.23	0.649
Business Plan	4.26	0.828
Business Credit Report	4.40	0.767
Income Tax Returns	3.35	1.066
Bank Statements	3.95	1.045
Collateral Documents	4.40	0.791
List of Guarantees Proposed	3.91	1.065
Legal Documents	4.74	0.658

Table 5.5: Bank lending officers' familiarity with accounting measurement concepts

Measurement concept	Mean	SD
Historical cost	3.56	1.333
Lower of cost or market value	4.05	1.045
Value in use	3.51	1.298
Fair value	3.77	1.130

Table 5.6: Bank lending officers' preference for accounting measurement concepts

Measurement concept	Mean	SD
All assets and liabilities should be reported following the same measurement concept	4.12	1.051
All assets and liabilities should be reported at fair value, with historical cost information presented in the notes	3.63	1.155
All assets and liabilities should be reported at historical cost, with fair value information presented in the notes	3.33	1.107
Assets and liabilities should be reported following different measurement concepts, with the relevant measurement concept depending on the nature of the asset or liability	3.00	1.175
Companies should be permitted to choose between alternative measurement concepts for different classes of assets and/or liabilities	2.93	1.242

Table 5.7: Usefulness of accounting disclosure items in IFRS for SMEs

No.	Information Item	Chi-Square [a]	df	Asymp. Sig.	Mean	SD
Items 1-18: Statement of financial position (Balance Sheet)						
1	Cash and cash equivalents	42.186	2	0.000***	4.21	0.833
2	Trade and other receivables	74.419	2	0.000***	4.49	0.668
3	Financial assets	50.000	2	0.000***	4.16	0.754
4	Inventories	31.302	2	0.000***	3.93	0.910
5	Property, plant and equipment measured at historical cost	9.116	2	0.010**	3.51	1.142
6	Investment property carried at fair value through profit or loss	14.698	2	0.001***	3.53	0.984
7	Intangible assets	8.419	2	0.015**	3.53	1.202
8	Biological assets carried at cost less accumulated depreciation and impairment	3.535	2	0.171	3.16	1.194
9	Biological assets carried at fair value through profit or loss	2.419	2	0.298	3.16	1.045
10	Investments in associates carried at fair value through profit or loss	15.953	2	0.000***	3.60	1.003
11	Investments in jointly controlled entities carried at fair value through profit or loss	4.233	2	0.120	3.30	1.013
12	Trade and other payables	39.093	1	0.000***	4.40	0.541
13	Financial liabilities (except trade & other payables and provisions)	25.326	1	0.000***	4.47	0.702
14	Liabilities and assets for current tax	5.628	2	0.060*	3.44	1.119
15	Deferred tax liabilities and deferred tax assets	6.186	2	0.045**	3.26	0.954
16	Provisions	21.256	2	0.000***	3.72	1.008
17	Non-controlling interests, presented within equity separately from equity attributable to the owners of the parent	19.023	2	0.000***	3.16	0.754
18	Equity attributable to the owners of the parent	15.953	2	0.000***	3.53	1.008
Items 19-25: Sub-classification of statement of financial position (Balance Sheet)						
19	Property, plant and equipment in classifications appropriate to the entity	27.395	2	0.000***	4.02	1.035
20	Trade and other receivables showing separately amounts due from related parties, amounts due from other parties, and receivables arising from accrued income not yet billed	68.977	2	0.000***	4.30	0.741
21	Inventories, showing separately amounts of inventories: a) held for sale in the ordinary course of business b) in the process of production for such sale c) in the form of materials or supplies to be consumed in the production process or in the rendering of services	20.837	2	0.000***	3.60	0.623
22	Trade and other payables, showing separately amounts payable to trade suppliers, payable to related parties, deferred income and accruals	28.488	1	0.000***	4.23	0.611
23	Provisions for employee benefits and other provisions	13.581	2	0.001***	3.60	0.877

24	Classes of equity, such as paid-in capital, share premium, retained earnings and items of income and expense	37.023	2	0.000***	3.93	0.985
25	An entity with share capital, for each class of share capital: a) the number of shares authorised b) the number of shares issued and fully paid, and issued but not fully paid c) par value per share, or that the shares have no par value d) a reconciliation of the number of shares outstanding at the beginning and at the end of the period e) the rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital f) shares in the entity held by the entity or by its subsidiaries or associates g) shares reserved for issue under options and contracts for the sale of shares, including the terms and amounts	7.581	2	0.023**	3.47	1.054
Items 26-39: Income statement and statement of comprehensive income						
26	Revenue[b]	-	-	-	4.74	0.441
27	Finance costs	31.837	1	0.000***	4.65	0.613
28	Share of the profit or loss of investments in associates	53.907	2	0.000***	4.19	0.794
29	Share of the profit or loss of jointly controlled entities accounted for using the equity method	45.953	2	0.000***	3.88	1.028
30	Tax expense	24.744	2	0.000***	3.81	1.006
31	A single amount comprising the total of: a) the post-tax profit or loss of a discontinued operation, and b) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the net assets constituting the discontinued operation	26.558	2	0.000***	3.84	0.898
32	Profit or loss	39.093	1	0.000***	4.81	0.450
33	Each item of other comprehensive income classified by nature	25.326	1	0.000***	4.30	0.674
34	Share of the other comprehensive income of associates and jointly controlled entities accounted for by the equity method	2.814	1	0.093*	3.77	0.684
35	Total comprehensive income	31.837	1	0.000***	4.23	0.571
36	Profit or loss for the period attributable to: a) non-controlling interest b) owners of the parent	17.628	2	0.000***	3.65	0.783
37	Total comprehensive income for the period attributable to: a) non-controlling interest b) owners of the parent	14.000	2	0.001***	3.53	0.767

38	An analysis of expenses using a classification based on the nature of expenses (e.g. depreciation, purchases of materials, transport costs, employee benefits and advertising costs) within the entity	12.302	1	0.000***	4.16	0.785
39	An analysis of expenses using a classification based on the function of expenses (e.g. cost of sales, cost of distribution or administrative activities) within the entity	8.395	1	0.004***	4.07	0.799
Items 40-43: Statement of changes in equity and retained earnings						
40	Total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to non-controlling interests	44.698	2	0.000***	3.88	0.793
41	For each component of equity, the effects of retrospective application or retrospective restatement recognised	14.698	2	0.001***	3.65	0.870
42	For each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing changes resulting from: a) profit or loss b) each item of other comprehensive income c) the amounts of investments by, and dividends and other distributions to, owners, showing separately issues of shares, treasury share transactions, dividends and other distributions to owners, and changes in ownership interests in subsidiaries that do not result in a loss of control	23.070	2	0.000***	3.91	1.019
43	In the statement of income and retained earnings: a) retained earnings at the beginning of the reporting period b) dividends declared and paid or payable during the period c) restatements of retained earnings for corrections of prior period errors d) restatements of retained earnings for changes in accounting policy e) retained earnings at the end of the reporting period	41.349	2	0.000***	4.09	0.840
Items 44-52: Cash flow statement						
44	Cash flows for a reporting period classified by operating activities, investing activities and financing activities	63.674	2	0.000***	4.47	0.797
45	Cash flows from operating activities using: the indirect method, whereby profit or loss is adjusted for the effects of non-cash transactions, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows	33.535	2	0.000***	4.19	0.982
46	Cash flows from operating activities using: the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed	24.744	2	0.000***	3.98	0.963
47	Major classes of gross cash receipts and gross cash payments arising from investing activities	22.372	2	0.000***	3.98	0.988

48	Major classes of gross cash receipts and gross cash payments arising from financing activities	49.163	2	0.000***	4.26	0.902
49	Cash flows arising from transactions in a foreign currency	15.953	2	0.000***	3.72	1.098
50	Cash flows from interest and dividends received and paid	17.070	2	0.000***	3.81	0.982
51	Cash flows arising from income tax	19.860	2	0.000***	3.72	1.098
52	The amount of significant cash and cash equivalent balances held by the entity that are not available for use by the entity (because of foreign exchange controls or legal restrictions, etc.)	19.860	2	0.000***	3.79	1.013
Items 53-56: Notes to the financial statements						
53	A statement that the financial statements have been prepared in compliance with the SLFRS for SMEs	28.488	1	0.000***	4.26	0.621
54	A summary of significant accounting policies applied: a) the measurement basis (or bases) used in preparing the financial statements b) the other accounting policies used that are relevant to an understanding of the financial statements	8.395	1	0.004***	3.91	0.684
55	The judgments, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements	16.953	1	0.000***	4.12	0.697
56	The key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year	14.535	1	0.000***	4.14	0.743

* Significant at $p < 0.10$, ** Significant at $p < 0.05$, ***Significant at $p < 0.01$

[a] The obtained observations were reclassified as follows:

Value on Likert Scale	*New value assigned*	
1-2	1	Not Useful
3	2	Neutral
4-5	3	Useful

[b] As this variable is constant (see Table 5.10, Q26), Chi-square test cannot be performed.

Table 5.8: The frequency percentage of responses on usefulness of accounting disclosure items in Balance Sheet

Scale[a]	Frequency Percent																	
	Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10	Q11	Q12	Q13	Q14	Q15	Q16	Q17	Q18
1	2.3	2.3	2.3	4.7	16.5	7	18.6	34.9	30.2	11.6	18.6	0	0	16.3	16.3	9.3	9.3	11.6
2	18.6	2.3	14	23.3	30.2	39.5	27.9	20.9	25.6	27.9	39.5	2.3	11.6	41.8	46.5	25.6	62.8	27.9
3	79.1	95.4	83.7	72	53.3	53.5	53.5	44.2	44.2	60.5	41.9	97.7	88.4	41.9	37.2	65.1	27.9	60.5
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Table 5.9: The frequency percentage of responses on usefulness of accounting disclosure items in Balance Sheet Sub-Classifications

Scale[a]	Frequency Percent						
	Q19	Q20	Q21	Q22	Q23	Q24	Q25
1	7	4.7	2.3	0	7	7	14
2	23.3	2.3	39.5	9.3	44.2	16.3	39.5
3	69.7	93	58.2	90.7	48.8	76.7	46.5
Total	100	100	100	100	100	100	100

Table 5.10: The frequency percentage of responses on usefulness of accounting disclosure items in Income Statement and Comprehensive Income

Scale[a]	Frequency Percent													
	Q26	Q27	Q28	Q29	Q30	Q31	Q32	Q33	Q34	Q35	Q36	Q37	Q38	Q39
1	0	0	4.7	16.3	7	9.3	0	0	0	0	4.7	9.3	0	0
2	0	7	9.3	2.3	25.6	20.9	2.3	11.6	37.2	7	39.5	34.9	23.3	27.9
3	100	93	86	81.4	67.4	69.8	97.7	88.4	62.8	93	55.8	55.8	76.7	72.1
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Table 5.11: The frequency percentage of responses on usefulness of accounting disclosure items in Statement of Changes in Equity and Retained Earnings

Scale[a]	Frequency Percent			
	Q40	Q41	Q42	Q43
1	9.3	7	11.6	4.7
2	9.3	39.5	20.9	16.3
3	81.4	53.5	67.5	79
Total	100	100	100	100

Table 5.12: The frequency percentage of responses on usefulness of accounting disclosure items in Cash Flow Statement

Scale[a]	Frequency Percent								
	Q44	Q45	Q46	Q47	Q48	Q49	Q50	Q51	Q52
1	4.7	7	7	7	7	11.6	9.3	14	14
2	4.7	18.6	25.6	27.9	9.3	27.9	30.2	20.9	20.9
3	90.6	74.4	67.4	65.1	83.7	60.5	60.5	65.1	65.1
Total	100	100	100	100	100	100	100	100	100

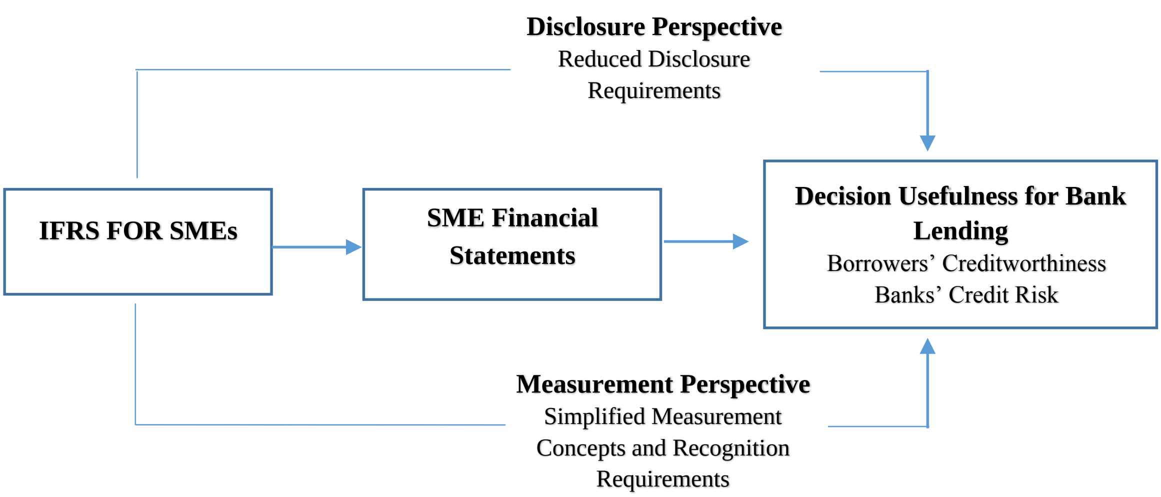
Table 5.13: The frequency percentage of responses on usefulness of accounting disclosure items in Notes to the Financial Statements

Scale[a]	Frequency Percent			
	Q53	Q54	Q55	Q56
1	0	0	0	0
2	9.3	27.9	18.6	20.9
3	90.7	72.1	81.4	79.1
Total	100	100	100	100

Table 5.14: Profile of the interviewees

Bank	Number of Interviewees	Average Experience in SME Lending (in years)	Age (mean)
A	4	10.20	45
B	6	9.67	37
C	4	10.75	45
D	5	7	45
Total	19	9.31	42

Figure 5.1: Conceptual framework for assessing the decision-usefulness of IFRS for SMEs on bank lending decisions



CHAPTER 6

Summary and Conclusions

6.0 INTRODUCTION

The aim of this thesis was to undertake a comprehensive examination of some controversial issues challenging the adoption of IFRS for SMEs and suggest possible ways to address these issues. In particular, four research projects were undertaken to address the four objectives of this thesis. Paper 1 presented extensive insights on the adoption of IFRS for SMEs, including the development and implementation process of the standard. Paper 2 provided empirical evidence on how well accountants are able to distinguish between the recognition and measurement principles of full IFRS and IFRS for SMEs, independent of their prior understanding of full IFRS when they interpret and apply IFRS for SMEs. Paper 3 provided empirical evidence on whether the reduced guidance in IFRS for SMEs has a significant impact on the judgments of accountants when they interpret and apply these standards. Paper 4 provided empirical evidence on bank lending officers' perceptions of the decision usefulness of financial statements prepared in compliance with IFRS for SMEs on their lending decisions.

This chapter is organized as follows. Section 6.1 presents the summary and implications of each of the four papers. Section 6.2 summarises the overall conclusions and implications drawn from the entire thesis. Section 6.3 outlines the limitations of this thesis together with the suggestions for future research.

6.1 SUMMARIES AND IMPLICATIONS OF THE INDIVIDUAL STUDIES

Paper 1: Issues in the Adoption of International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs)

The objective of this study was to carry out a comprehensive examination of the adoption of IFRS for SMEs, including the development and implementation processes of the standard. The study indicated that IFRS for SMEs have been a challenge for non-publicly accountable entities to adopt due to several conceptual and practical issues pertaining to IFRS for SMEs. The investigations on the development process of the standard revealed that the IASB has not adequately addressed the user orientation during the standard setting process of IFRS for SMEs. The study showed that the inadequate user involvement in the accounting standard process may impair the decision usefulness of accounting information for users.

The study revealed numerous implementation issues pertaining to the standard as denoted by the countries which have adopted and those which are opposed to the adoption of IFRS for SMEs. The study showed that countries opposed to the adoption have identified many problems with IFRS for SMEs, including the perceived burden for small and micro-entities, inconsistency with reporting frameworks at national level and difficulties in the adoption process. The study indicated that the inconsistency between the IASB definition of SMEs and different definitions adopted by countries to define SMEs poses difficulties in implementing the standard. Furthermore, technical difficulties inherent in certain sections of IFRS for SMEs and their potential complexity in the preparation of financial statements were also evidenced. Especially, the study revealed that the lack of availability of capital market information and differences in the liquidity of capital markets are challenging when applying the fair value measurement requirements in IFRS for SMEs. The study further revealed that the simplification in recognition and measurement requirements of IFRS for SMEs, such as the requirement to expense all borrowing costs to a profit and loss account significantly impact the financial performance of SMEs.

The study showed that the requirement to fall back to full IFRS in the absence of adequate guidance in IFRS for SMEs may result in inconsistent application of the standard. The analysis further showed that the differential reporting framework may create inconsistency in the true and fair view principle among entities in the same jurisdiction. Overall, the study stresses that the exaggeration on the simplification of accounting principles and difficulties involved in the implementation of the standard may hinder achieving the IASB's objective of enhancing international access to finance through high quality and comparable financial information, and the expected benefits may not transfer effectively to the SMEs.

The analyses and insights provided by this study will have implications for the revision of IFRS for SMEs, especially when the IASB carries out the next review of IFRS for SMEs and formulates future amendments to the standard. The findings will also assist in avoiding or minimising future complications in the adoption of IFRS for SMEs. The analyses also provide important insights for prospective countries that are planning to adopt an international set of standards in their jurisdictions.

Paper 2: Confirmation Bias in the Reporting Judgments of Accountants When Applying International Financial Reporting Standards (IFRS) For Small and Medium-Sized Enterprises (SMEs)

This study investigated one of the perceived complications associated with the simplified recognition and measurement principles of IFRS for SMEs. Employing a behavioural experimental approach with a sample of accountants from a country that has adopted IFRS for SMEs, the primary objective of this study was to investigate the effect of confirmation bias arising from prior knowledge and beliefs about full IFRS on the reporting judgments of accountants when applying IFRS for SMEs. Additionally, the study examined the role that judgment justification requirements and the availability of decision aids play in mitigating the confirmation bias that arises from prior knowledge and beliefs on full IFRS.

The results substantiate the notion that accountants who have a tendency to confirm prior knowledge and beliefs about full IFRS are unlikely to choose the accounting treatment that best reflects the economic substance of a transaction when applying IFRS for SMEs. The results further demonstrate that (1) inducing a form of justification requirement and (2) providing an appropriately designed decision aid that makes a clear distinction between the recognition and measurements principles of full IFRS and IFRS for SMEs can eliminate the confirmation bias associated with prior knowledge and beliefs about full IFRS. Overall, the study concludes that SMEs will reap the benefits of compliance with IFRS for SMEs only when the financial statement preparer's mindset shifts and they accept IFRS for SMEs as a stand-alone set of standards.

This study contributes to a wide range of the accounting community in several ways. The findings of this study indicate that applying two different versions of accounting standards in the same jurisdiction (i.e., the differential reporting framework) may lead to inconsistency in the application of IFRS for SMEs, thus hindering the comparability of financial information across entities. The study suggests the need to enhance accountants' awareness of the differences between full IFRS and IFRS for SMEs to overcome biases in judgments and to enhance the reporting quality and the comparability of accounting information. Such findings will be of interest to the accounting standard setters and regulatory bodies who wish to minimise these complications in the future. The findings of this study also encourage additional investments in accounting education and training to increase accountants' knowledge, understanding and expertise in the application of IFRS for SMEs which will be of interest to the accounting policy makers and accounting educators in countries adopting IFRS for SMEs.

Paper 3: The Impact of the Reduced Guidance in International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs) on the Reporting Judgments of Accountants

This study investigated the impact of the reduced guidance in IFRS for SMEs on the reporting judgments of accountants. Using an experiment with a sample of accountants from a country that has adopted IFRS for SMEs, this study primarily explored whether the reduced guidance provided in IFRS for SMEs is adequate for making accurate reporting judgments for SMEs. The study further investigated the effectiveness of examples provided as guidance on the reporting judgments of accountants. The relative effectiveness of explicit guidance and the examples for making accurate reporting judgments was also examined.

The results substantiate the notion that accountants who refer to the reduced guidance in IFRS for SMEs are unlikely to choose the accounting treatment that best reflects the economic substance of a transaction than accountants who refer to detailed guidance in full IFRS. The findings further reveal that accountants tend to overstate the similarities presented in the examples, biasing their judgments towards the treatment illustrated in the examples. The results indicate that explicit guidance is not relatively more effective than examples when limited explicit guidance is available for making reporting judgments. The study further reveals that accountants receiving a combination of examples and explicit guidance make significantly more accurate judgments than accountants receiving IFRS for SMEs guidance or examples alone. Overall, the study stresses that the guidance provided in IFRS for SMEs is insufficient for making sound reporting judgments and impairs the accuracy of the reporting judgments of accountants. In line with prior research, the study confirms that the directional effects of examples potentially influence the accuracy of the judgments. As such, the study concludes that examples cannot be considered as effective guidance when presented alone.

The findings of the study suggest that the IASB's objective of comparability of SME financial information can be improved by providing sufficient guidance on appropriate accounting treatments in IFRS for SMEs. The additional implementation guidance has to be provided in order to avoid confusion and complications in applying IFRS for SMEs. The findings also suggest that the IASB may need to reconsider the inclusion of similar accounting measurement and recognition principles of full IFRS in IFRS for SMEs to improve the comparability of SME financial information. The study also brings to the attention that particular care has to be taken when incorporating examples in the accounting standards. Overall, the findings of this study will be of interest to the IASB when shaping the optimal format of accounting standards.

Paper 4: User Perceptions of the Decision Usefulness of Financial Statements prepared in compliance with International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs)

This study examined bank lending officers' perceptions of the decision usefulness of financial statements prepared in compliance with IFRS for SMEs on SME lending decisions. The focus of the study was mainly on two aspects of the simplification of IFRS for SMEs: (1) the decision usefulness of the reduced disclosure requirements of IFRS for SMEs and (2) the decision usefulness of the simplified recognition and measurement requirements of IFRS for SMEs.

The study provides evidence that the disclosure requirements of IFRS for SMEs are useful for lending decisions for SMEs. The study also provides evidence that bank lending officers do not consider that the simplification in the recognition and measurement requirements of IFRS for SMEs significantly improves their lending decisions. The findings make it apparent that banks, as one of the major user groups of SME financial information, are in a position to demand the information they need, thus they do not see any major issues with the simplification in recognition and measurement requirements. Further, the findings indicate that as IFRS for SMEs is a new standard, banks have limited awareness and experience in interpreting IFRS for SMEs-based financial reports. In general, the findings suggest that bank lending officers have limited interest in information, such as accounting basis, on which the financial statements are prepared.

The findings of this study provide important insights to the accounting regulators, including the IASB, for evaluating the successful implementation of IFRS for SMEs and planning the next review of IFRS for SMEs. Further, the findings signify the need for user involvement in the standard setting process, particularly when future amendments are made to the standard. The findings further brought to attention that raising awareness among the different user groups of SME financial statements about the accounting standards and their simplifications is timely and essential. This study also contributes to the limited literature on the accounting information needs of the users of SME financial statements.

6.2 OVERALL CONCLUSIONS AND FURTHER IMPLICATIONS

Motivated by the growing demand for empirical evidence on the adoption and implementation of IFRS for SME, this thesis conducted a comprehensive examination of controversial issues pertaining to the adoption of IFRS for SMEs. Exploring empirical evidence from countries that have adopted IFRS for SMEs, this thesis provided evidence that IFRS for SMEs in its present state poses intense challenges for the consistent interpretation and application of the standard.

The IASB's primary intention of the simplified stand-alone set of standards was to reduce the SME financial reporting burden associated with compliance with full IFRS. The IASB has also placed great emphasis on enhancing the comparability of SME financial information with the adoption of IFRS for SMEs. The findings of this thesis suggest that the overemphasis given to simplification in recognition and measurement requirements and guidance are perceived to be challenging for SMEs, particularly when accountants exercise professional judgment. As the principles-based IFRS require extensive application of professional judgment, the differential reporting framework has led to complications in interpretation and application of the standard. Particularly, the findings of this thesis revealed that the preparers' judgments under IFRS for SMEs requirements are vulnerable to judgmental biases and inconsistent application of the standards, which may hinder the objective of comparability of financial information across the SMEs, and impair the financial reporting quality. Overall, from the perspective of preparers of SME financial statements, this thesis concludes that preparers are unable to perceive IFRS for SMEs as a stand-alone set of standards.

From the user perspective of IFRS for SMEs, the findings of this thesis indicate that IFRS for SMEs generally satisfy the accounting information needs of users. Even though the simplification in IFRS for SMEs is not appealing to a great extent, users prefer that all SMEs prepare their financial statements in a uniform way, therefore, users perceive IFRS for SMEs as a positive step towards improving the accounting information needs of the users.

A number of policy implications derived from this thesis will be of interest to the IASB, accounting regulators, policy makers and accounting educators in countries adopting IFRS for SMEs. First, because of the principles-based nature and increasing application of professional judgment in IFRS for SMEs, the findings of this thesis stress the need to increase preparers' awareness of IFRS for SMEs in order to ensure effective communication of the standard. High quality financial reporting is essential for reducing information asymmetry and enhancing greater transparency in the economics of an organization. More specifically, the findings of this thesis foster investments in accounting education and training to improve accountants' knowledge and expertise in the effective application of IFRS for SMEs. Such investments may help overcome judgmental bias and the interpretation difficulties associated with IFRS for SMEs. Second, the findings concerning the reduced guidance in IFRS for SMEs have potential implications when the IASB contemplates future amendments to the standard and when shaping the optimal format of IFRS for SMEs. The implication of this for accounting educators is the importance of helping students to learn reasoning and the application of unbiased judgment, and applying the guidelines of IFRS for SMEs appropriately.

Third, the findings relating to user perceptions of the decision usefulness of IFRS for SMEs suggest to the accounting standards setters and accounting regulatory bodies at the individual jurisdiction level to increase users' awareness of simplified IFRS for SMEs. For accounting information to be decision useful, it must be clear, concise and comparable across entities. Increasing awareness of the differences in the recognition and measurement requirements of full IFRS and in IFRS for SMEs may avoid confusion and improve users' decision-making processes by enhancing users' confidence about the allocation of resources (particularly on investment and lending decisions). Such benefits will eventually pass on to the SMEs, and ultimately, this will help in strengthening the economic output of many economies.

Fourth, the findings concerning users' preference for the application of the same measurement principles across all entities indicates that the measurement principles should be independent of the nature of the entities and their users. Such findings substantiate the need for user involvement in the standard setting process. User involvement in the standard setting process would help to gauge the responses of the user groups, their interests and their eventual acceptance of the standard. Even though user involvement in the accounting standard process has been an on-going debate since IFRS for SMEs came into effect, the IASB's attempt to increase user involvement for the next review of IFRS for SMEs also indicates that an appropriate level of user representation is needed for accounting standard setting. Such attempts may accomplish the decision-usefulness objective of accounting by providing useful and relevant accounting information for the economic decision making of users.

Overall, the outcomes of this thesis give some indication that IFRS for SMEs in its present state have been unable to convey the benefits to SMEs as anticipated by the IASB. The findings of this thesis encourage the implementation of the reduced disclosure regime, allowing financial reporting of SMEs to be less complex by providing certain exemptions from the disclosures but retaining similar recognition and measurement principles that are contained in the full set of IFRS. This approach will move all listed and non-listed entities towards the preparation of general purpose financial statements by increasing consistency and transparency whilst upholding the relevance of the financial statements to the users. This approach may also spread the adoption of IFRS for SMEs further by attracting many developed and developing countries which regarded the differences in the simplification of accounting policies and principles in full IFRS and IFRS for SMEs as a significant barrier to its adoption.

6.3 LIMITATIONS AND SUGGESSIONS FOR FUTURE RESEARCH

This thesis has some limitations and the findings of this study should be evaluated in light of these limitations. This study has used both exploratory and experimental research approaches to examine the issues in the adoption of IFRS for SMEs. While there are numerous benefits of using these approaches in research, certain drawbacks also need to be acknowledged.

First, the use of the exploratory research approach has its own limitations. In analysing the findings on the issues in the adoption of IFRS for SMEs (Chapter 2), the study was limited to prior studies that reported on the transformation of the full set of IFRS, IFRS for SMEs, and recent information published by the IFRS Foundation and prominent professional accounting bodies on the implementation of IFRS for SMEs. The use of secondary research sources, such as prior literature and discussions, may be susceptible to interpreter bias and limit generalizability. However, attempts were made to overcome certain drawbacks by collecting as many relevant materials as possible and using theoretical frameworks to interpret the data. In order to enhance generalizability, future research could be undertaken in various jurisdictions to reveal the actual implementation difficulties and issues encountered at the country and/or regional level in the adoption of IFRS for SMEs. From the perspective of those countries that have already adopted the new standard, future studies could also investigate the cost-benefit considerations of IFRS for SMEs.

Second, even though experimental research provides robust causal interpretational evidence (Libby, Bloomfield, & Nelson, 2002), the simulated results may not be generalized into real-world situations. In an actual accounting environment, accountants have incentives for vigilant information processing and their behaviour is not observed as in the experimental setting. Additionally, the experimental research designs are usually contrived scenarios that do not absolutely represent the events and incidents that happen in the real world, and also experiments usually have to be limited to one situation or condition. In this thesis, the experiment on confirmation bias in reporting judgments was examined across the recognition of revenues decision context (Chapter 3), and the impact of the reduced guidance on the reporting judgment of accountants was examined across the recognition of investments in an associate decision context (Chapter 4). However, in this thesis, numerous steps were followed to ensure valid research outcomes and to enhance the generalizability of the findings, such as (1) the application of psychological theories to predict the outcomes of the effects, (2) attempting to design scenarios that mimic actual accounting incidences, (3) extensive pilot testing of the research instruments, (4) careful selection of relevant samples and sample sizes and (5) the use of appropriate statistical techniques for data analysis. To broaden the generalizability of the results of this thesis, future studies could explore the impact of simplified recognition and measurement requirements and the reduced guidance of IFRS for SMEs in other decision contexts and their impact on the reporting decisions of financial statement preparers.

Third, this thesis only considered judgment justification and decision aids as the factors moderating confirmation bias in reporting judgments. Future research could also explore other factors and alternative decision aids, such as worked examples on improving judgment and decision making performance of accountants. Future studies could also examine why there are varying levels of confirmation bias among the preparers of financial statements and how this relates to the different cognitive strategies preparers may develop in the context of applying IFRS for SMEs. Additionally, the findings of this thesis call for further empirical research to explore the reasons why the preparers of financial statements are not yet prepared to accept IFRS for SMEs as a stand-alone set of standards. Fourth, the accountants who participated in the experiments of this thesis received no incentives to influence their reporting judgments. Future studies could examine how judgmental bias could be avoided when accountants are presented with explicit incentives for accurate reporting.

Fifth, evaluating the user perceptions of the decision usefulness of IFRS for SMEs from one user group of SME financial statements will not represent the perceptions of different user groups, thus limiting the generalizability of the findings. The findings of this thesis provide an avenue for future research to investigate the perceptions of other stakeholders, such as creditors and tax authorities, on the decision usefulness of IFRS for SMEs.

Finally, the empirical studies of this thesis were carried out only at two jurisdictions (Fiji and Sri Lanka) that have adopted IFRS for SMEs. For this reason, the findings cannot be generalized to the broader community based on this thesis alone. As the IASB continues monitoring the implementation experience and the need to make amendments to the standard, the findings of this thesis warrant future research that could attempt to replicate the findings with respect to other countries that have adopted or opted for the adoption of IFRS for SMEs.

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APPENDIX 1

Ethics Approval Letters

MACQUARIE University

KALUTHANTHRIGE PERERA <kaluthanthrige.perera@students.mq.edu.au>

Approved - 5201300592

Mrs Yanru Ouyang <yanru.ouyang@mq.edu.au> Fri, Sep 27, 2013 at 8:49 AM
To: Mr Parmod Chand <parmod.chand@mq.edu.au>
Cc: Dr Rajni Mala <rajni.mala@mq.edu.au>, Mrs Dinuja Dona Dinuja Perera <kaluthanthrige.perera@students.mq.edu.au>

Dear Mr Chand,

Re: 'Factors affecting professional judgment of accountants.'

Reference No.: 5201300592

Thank you for your recent correspondence. Your response has addressed the issues raised by the Faculty of Business & Economics Human Research Ethics Sub Committee. Approval of the above application is granted, effective "27/09/2013". This email constitutes ethical approval only.

This research meets the requirements of the National Statement on Ethical Conduct in Human Research (2007). The National Statement is available at the following web site:

http://www.nhmrc.gov.au/_files_nhmrc/publications/attachments/e72.pdf.

The following personnel are authorised to conduct this research:

Dr Rajni Mala
Mr Parmod Chand
Mrs Dinuja Dona Dinuja Perera

NB. STUDENTS: IT IS YOUR RESPONSIBILITY TO KEEP A COPY OF THIS APPROVAL EMAIL TO SUBMIT WITH YOUR THESIS.

Please note the following standard requirements of approval:

1. The approval of this project is conditional upon your continuing compliance with the National Statement on Ethical Conduct in Human Research (2007).

2. Approval will be for a period of five (5) years subject to the provision of annual reports.

Progress Report 1 Due: 27th Sep. 2014
Progress Report 2 Due: 27th Sep. 2015
Progress Report 3 Due: 27th Sep. 2016
Progress Report 4 Due: 27th Sep. 2017
Final Report Due: 27th Sep. 2018

NB. If you complete the work earlier than you had planned you must submit a Final Report as soon as the work is completed. If the project has been discontinued or not commenced for any reason, you are also required to submit a Final Report for the project.

Progress reports and Final Reports are available at the following website:

http://www.research.mq.edu.au/for/researchers/how_to_obtain_ethics_approval/human_research_ethics/forms

3. If the project has run for more than five (5) years you cannot renew

approval for the project. You will need to complete and submit a Final Report and submit a new application for the project. (The five year limit on renewal of approvals allows the Committee to fully re-review research in an environment where legislation, guidelines and requirements are continually changing, for example, new child protection and privacy laws).

4. All amendments to the project must be reviewed and approved by the Committee before implementation. Please complete and submit a Request for Amendment Form available at the following website:

http://www.research.mq.edu.au/for/researchers/how_to_obtain_ethics_approval/human_research_ethics/forms

5. Please notify the Committee immediately in the event of any adverse effects on participants or of any unforeseen events that affect the continued ethical acceptability of the project.

6. At all times you are responsible for the ethical conduct of your research in accordance with the guidelines established by the University. This information is available at the following websites:

http://www.mq.edu.au/policy/
http://www.research.mq.edu.au/for/researchers/how_to_obtain_ethics_approval/human_research_ethics/policy

If you will be applying for or have applied for internal or external funding for the above project it is your responsibility to provide the Macquarie University's Research Grants Management Assistant with a copy of this email as soon as possible. Internal and External funding agencies will not be informed that you have approval for your project and funds will not be released until the Research Grants Management Assistant has received a copy of this email.

If you need to provide a hard copy letter of approval to an external organisation as evidence that you have approval, please do not hesitate to contact the FBE Ethics Committee Secretariat, via fbe-ethics@mq.edu.au or 9850 4826.

Please retain a copy of this email as this is your official notification of ethics approval.

Yours sincerely,

Parmod Chand
Chair, Faculty of Business and Economics Ethics Sub-Committee
Faculty of Business and Economics
Level 7, E4A Building
Macquarie University
NSW 2109 Australia
T: +61 2 9850 4826
F: +61 2 9850 6140
www.businessandeconomics.mq.edu.au/

MACQUARIE University

KALUTHANTHRIGE PERERA <kaluthanthrige.perera@students.mq.edu.au>

Approved - 5201400850

Mrs Yanru Ouyang <fbe-ethics@mq.edu.au> Fri, Sep 26, 2014 at 10:05 AM
To: Mr Parmod Chand <parmod.chand@mq.edu.au>
Cc: Mrs Rajni Mala <rajni.mala@mq.edu.au>, Mrs Dinuja Dona Dinuja Perera <kaluthanthrige.perera@students.mq.edu.au>

Dear Mr Chand,

Re: 'The Impact of Reduced Guidance in International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs) on the Professional Judgments of Accountants.'

Reference No.: 5201400850

Thank you for your recent correspondence. Approval of the above application is granted, effective "26/09/2014". This email constitutes ethical approval only.

This research meets the requirements of the National Statement on Ethical Conduct in Human Research (2007). The National Statement is available at the following web site:

http://www.nhmrc.gov.au/_files_nhmrc/publications/attachments/e72.pdf.

The following personnel are authorised to conduct this research:

Mr Parmod Chand
Mrs Dinuja Dona Dinuja Perera
Mrs Rajni Mala

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2. Approval will be for a period of five (5) years subject to the provision of annual reports.

Progress Report 1 Due: 26 September 2015
Progress Report 2 Due: 26 September 2016
Progress Report 3 Due: 26 September 2017
Progress Report 4 Due: 26 September 2018
Final Report Due: 26 September 2019

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Please retain a copy of this email as this is your official notification of ethics approval.

Yours sincerely,

Nikola Balnave
ActingChair, Faculty of Business and Economics Ethics Sub-Committee
Faculty of Business and Economics
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Macquarie University
NSW 2109 Australia
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MACQUARIE University

KALUTHANTHRIGE PERERA <kaluthanthrige.perera@students.mq.edu.au>

Approved - 5201401179

Mrs Yanru Ouyang <fbe-ethics@mq.edu.au> Tue, Dec 9, 2014 at 11:35 AM
To: Mr Parmod Chand <parmod.chand@mq.edu.au>
Cc: Mrs Rajni Mala <rajni.mala@mq.edu.au>, Mrs Dinuja Dona Dinuja Perera <kaluthanthrige.perera@students.mq.edu.au>

Dear Mr Chand,

Re: 'Users' Perceptions on the Decision Usefulness of the Financial Statements prepared under International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs).'

Reference No.: 5201401179

Thank you for your recent correspondence. Your response has addressed the issues raised by the Faculty of Business & Economics Human Research Ethics Sub Committee. Approval of the above application is granted, effective "9/12/2014". This email constitutes ethical approval only.

This research meets the requirements of the National Statement on Ethical Conduct in Human Research (2007). The National Statement is available at the following web site:

http://www.nhmrc.gov.au/_files_nhmrc/publications/attachments/e72.pdf.

The following personnel are authorised to conduct this research:

Mr Parmod Chand
Mrs Dinuja Dona Dinuja Perera
Mrs Rajni Mala

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Please note the following standard requirements of approval:

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2. Approval will be for a period of five (5) years subject to the provision of annual reports.

Progress Report 1 Due: 9th Dec 2015
Progress Report 2 Due: 9th Dec 2016
Progress Report 3 Due: 9th Dec 2017
Progress Report 4 Due: 9th Dec 2018
Final Report Due: 9th Dec 2019

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Please retain a copy of this email as this is your official notification of ethics approval.

Yours sincerely,

Parmod Chand
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APPENDIX 2

Research Instrument – Paper 2

(Version 1 – No Justification Requirement and No Guidance)

Department of Accounting and Corporate Governance
Faculty of Business and Economics
Macquarie University NSW 2109
Phone: +61 2 9850 6137
Fax: +61 2 9850 8497
Email: parmod.chand@mq.edu.au

Participant Information Form

Factors Affecting Professional Judgment of Accountants

Supervisors: Dr Parmod Chand and Dr Rajni Mala

You are invited to participate in a study of judgment in accounting. The purpose of this study is to examine the factors affecting professional judgment of accountants when they interpret and apply the Sri Lankan Financial Reporting Standards (SLFRS) for Small and Medium-Sized Enterprises (SMEs), the equivalent of International Financial Reporting Standards (IFRS) for SMEs.

The study is being conducted by Dinuja Perera [Department of Accounting and Corporate Governance, dinuja.perera@mq.edu.au, Ph: (61) 414 729 623]. It is being conducted to meet the requirements of Doctor of Philosophy in Accounting and Corporate Governance under the supervision of Dr Parmod Chand [parmod.chand@mq.edu.au, Ph: (612) 9850 6137] and Dr Rajni Mala [rajni.mala@mq.edu.au, Ph: (612) 9850 8530] of the Department of Accounting and Corporate Governance, Macquarie University, NSW, Australia.

If you decide to participate, you will be asked to complete the questionnaire. The questionnaire is in two parts. Part one collects demographic data about the respondents. Part two consists of a small case study, and you are asked to provide your judgment on a scenario concerning a problem regarding appropriate financial reporting. It will take approximately 20-25 minutes to complete the questionnaire.

It is not expected in this study to gather information that represents your views about your work organization or institution, hence, you are not considered as a representative of your work organization or institution. Any information or personal details gathered in the course of the study are confidential, except as required by law. No individual will be identified in any publication of the results. Data will be analysed in aggregate form, held and accessed solely by the researchers (Dr Parmod Chand, Dr Rajni Mala and Dinuja Perera) and will not be used for any other purpose. The results of this study will be incorporated into Dinuja Perera's PhD thesis, which will be available at the Macquarie University Library for public access. A summary of the results of the data can be made available to you on request by emails to the researchers.

It would be greatly appreciated if you could please complete the attached questionnaire. Your time and co-operation in this study will be greatly appreciated. Participation in this survey is entirely voluntary and if you do not wish to participate you may simply not return the questionnaire. Completion and return of the questionnaire will be regarded as consent to use the information for research purposes.[1] You may contact Mr Chaminda Ruwan Thilakarathne [Ph: (94) 112 903 654] in relation to any ethical concerns about this study.

Please answer all questions. Your response is very important for the research which will contribute to understanding factors affecting professional judgment of accountants when interpreting and applying IFRS for SMEs.

[1] The ethical aspects of this study have been approved by the Macquarie University Human Research Ethics Committee. If you have any complaints or reservations about any ethical aspect of your participation in this research, you may contact the Committee through the Director, Research Ethics (telephone [02] 9850 7854, email: ethics@mq.edu.au). Any complaint you make will be treated in confidence and investigated, and you will be informed of the outcome.

Section 1

YOUR PERSONAL PROFILE

Please respond to the following questions so that a profile for respondents can be developed.

1.	**Are you:** Male ☐ Female ☐
2.	**How old are you?** ☐ Under 20 years ☐ 20-24 ☐ 25-29 ☐ 30-34 ☐ 35-39 ☐ 40-49 ☐ 50-59 ☐ 60 or over
3.	**In total, how many years of formal education (primary, secondary and tertiary) did you complete?** ☐ Less than 15 years ☐ 15 years ☐ 16 years ☐ 17 years ☐ 18 years or over
4.	**In which country did you complete your:** **Primary education** ___________ **Secondary education** ______________ **Tertiary education** ___________
5.	**Are you a member of:** ICASL ☐ ____________ Other (please specify)
6.	**How many years of professional experience do you have as a qualified accountant?** _______ Years
7.	**In which of the following areas do you specialize or work?** ☐ Accounting ☐ Audit ☐ Tax ☐ Consulting ___________ Other (please specify)
8.	**In which type of firm/organization do you work?** ☐ Big 4 Accounting Firm ☐ Non-Big 4 Accounting Firm ☐ SME (Small & Medium-sized Entity) ____________ Other(please specify)
9.	**How large (in terms of qualified professional accountants) is the firm/organization in which you work?** ☐ 1-5 ☐ 6-20 ☐ 21-100 ☐ Over 100
10.	**How familiar are you with Sri Lankan Financial Reporting Standards (SLAS) equivalents of IASs/IFRSs?** ☐ Very familiar ☐ Familiar ☐ Somewhat familiar ☐ Not familiar
11.	**How frequently do you refer to SLAS equivalents of IASs/IFRSs in your professional practice?** ☐ Often ☐ Sometimes ☐ Seldom ☐ Never
12.	**How familiar are you with SLFRS for SMEs equivalents of IFRS for SMEs?** ☐ Very familiar ☐ Familiar ☐ Somewhat familiar ☐ Not familiar
13.	**How frequently do you refer to SLFRS for SMEs equivalents of IFRS for SMEs in your professional practice?** ☐ Often ☐ Sometimes ☐ Seldom ☐ Never

Section 2

CASE STUDY
Below is a scenario and requires a judgment regarding the appropriate method of financial reporting. Please note that by indicating that you agree (or disagree) with the proposed accounting treatment, you will be understood to be disagreeing (or agreeing) with the other treatment. You may refer to the accounting standards in making your judgments.
You are asked to provide a judgment on the matter by providing a response on the scale 1 to 7 (please indicate by circling the relevant number).
The required judgment is based on SLFRS for SMEs equivalent of IFRS for SMEs.

Before attempting the case study provided on the next page, please indicate the extent to which you apply your prior knowledge of SLAS (Sri Lankan Financial Reporting Standards) when interpreting and applying the newly issued SLFRS for SMEs on the following scale.

Not at all			To Some Extent			To a Great Extent
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Case - Recognition of Revenue

"Dream Homes Real Estate" is a medium-sized non-listed company which engages in developing residential real estate and selling individual apartments. During its 10 years of successful business operations, Dream Homes has established an excellent record of being able to fulfill its obligations towards its customers as contracted. The company now prepares the financial statements in accordance with SLFRS for SMEs equivalent of IFRS for SMEs, and the company's financial year ends on 30th June.

At the beginning of 2013, Dream Homes purchased a new plot of land for the construction of individual apartments. It designed an apartment complex to be built on the land and submitted the designs to planning authorities in order to obtain building permissions. Once the designs were approved, Dream Homes started marketing the individual apartments. A buyer entered into an agreement with Dream Homes on 15th January 2013 for the sale of land and the construction of a two bedroom apartment in one of the land plots in the proposed apartment complex. The estimated purchase price of the apartment is LKR 15,000,000. The agreement prohibits the company from transferring the apartment to another customer. Dream Homes acquires all materials required for the construction from its subsidiary company Global Materials Private Limited. The estimated purchase price does not include any interior designing elements of the apartment. The apartment will be ready for occupation by 30th November 2013.

The buyer paid a non-refundable upfront deposit of LKR 2,000,000 on the agreement date for the construction. The buyer is also required to make three progress payments at three stages of completion, between the time of the initial agreement and contractual completion. These progress payments are designed to compensate the company for its performance to date. The buyer is able to specify only minor variations to the basic design. The agreement gives buyer the right to consult and contract with his own interior designers for arranging the interior designing components for each completed elements of the apartment over time. The company is responsible for remedying any minor construction defects detected before the contractual completion. The legal title of the apartment is passed to the buyer on contractual completion.

The company now has to decide whether to recognize revenue of this construction agreement using either stage of completion using the percentage of completion method or the completed contract method (i.e. on delivery of the completed real estate to the buyer at the end of the contract).

The Accountant "Y" who works for Dream Homes Real Estate holds the view that "the company can recognize the revenue of this construction agreement by reference to the stage of completion using the percentage of completion method as construction of this apartment progresses".

Record your judgment on Accountant Y's view that the company can recognize the revenue of this agreement using the percentage of completion method.

Case	**Strongly Disagree**						**Strongly Agree**
Judgment	1	2	3	4	5	6	7

Please place a tick in the appropriate box where 1 denotes that the recognition criterion was irrelevant and 10 denotes that the criterion was relevant in making the above judgment.

Criteria	Irrelevant 1	2	3	4	5	6	7	8	9	Relevant 10
1. If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver the real estate to the buyer, the agreement is an agreement for the sale of goods and the criteria for recognition of revenue apply.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
2. In an agreement for the sale of goods the entity may transfer to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
3. In an agreement for the sale of goods if all criteria for recognition of revenue are met continuously as construction progresses, the entity shall recognise revenue by reference to the stage of completion using the percentage of completion method.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
4. An entity that undertakes the construction of real estate and enters into an agreement with one or more buyers before construction is complete, shall account for the agreement as a sale of services, using the percentage of completion method if the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
5. The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
6. If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver the real estate to the buyer, the agreement is an agreement for the sale of goods but the buyer does not obtain control or the significant risks and rewards of ownership of the work in progress in its current state as construction progresses.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
7. It is probable that the economic benefits associated with the transaction will flow to the entity.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
8. An entity that undertakes the construction of real estate and enters into an agreement with one or more buyers before construction is complete, shall account for the agreement as a sale of services, using the percentage of completion method if the buyer acquires and supplies construction materials and the entity provides only construction services.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
9. The costs incurred or to be incurred in respect of the transaction can be measured reliably.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
10. The amount of revenue can be measured reliably.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

Please indicate the extent to which you applied your prior knowledge of SLAS (Sri Lankan Financial Reporting Standards) to come to an appropriate judgment on this case on the following scale:						
Not at All			**To Some Extent**			**To a Great Extent**
1 ☐	2 ☐	3 ☐	4 ☐	5 ☐	6 ☐	7 ☐
Please indicate how motivated you were to perform well on this case on the following scale:						
Not at All			**Moderately Motivated**			**Extremely Motivated**
1 ☐	2 ☐	3 ☐	4 ☐	5 ☐	6 ☐	7 ☐
Please indicate how much effort you have expended on this case on the following scale:						
Very Little Effort			**Moderate Effort**			**A Great Deal of Effort**
1 ☐	2 ☐	3 ☐	4 ☐	5 ☐	6 ☐	7 ☐
Please indicate the level of complexity of this case on the following scale:						
Not Complex			**Moderately Complex**			**Extremely Complex**
1 ☐	2 ☐	3 ☐	4 ☐	5 ☐	6 ☐	7 ☐
Please indicate your level of familiarity in dealing with similar cases like this on the following scale:						
Not Familiar			**Moderately Familiar**			**Very Familiar**
1 ☐	2 ☐	3 ☐	4 ☐	5 ☐	6 ☐	7 ☐

Please record the approximate time you spent to complete this survey:

Time Spent: ☐

Thank you for taking the time to complete this instrument. Your assistance is very much appreciated. If you have any further comments, please provide them in the space provided.

Please ensure that you have <u>answered every question</u>. Missing questions will mean all of your responses are unusable.

Dinuja Perera
Department of Accounting and Corporate Governance
Faculty of Business and Economics
Macquarie University
NSW 2109
Australia.

Thank you for your participation!

(Version 2 –Justification Requirement being Manipulated)

Department of Accounting and Corporate Governance
Faculty of Business and Economics
Macquarie University NSW 2109
Phone: +61 2 9850 6137
Fax: +61 2 9850 8497
Email: parmod.chand@mq.edu.au

Participant Information Form

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Supervisors: Dr Parmod Chand and Dr Rajni Mala

You are invited to participate in a study of judgment in accounting. The purpose of this study is to examine the factors affecting professional judgment of accountants when they interpret and apply the Sri Lankan Financial Reporting Standards (SLFRS) for Small and Medium-Sized Enterprises (SMEs), the equivalent of International Financial Reporting Standards (IFRS) for SMEs.

The study is being conducted by Dinuja Perera [Department of Accounting and Corporate Governance, dinuja.perera@mq.edu.au, Ph: (61) 414 729 623]. It is being conducted to meet the requirements of Doctor of Philosophy in Accounting and Corporate Governance under the supervision of Dr Parmod Chand [parmod.chand@mq.edu.au, Ph: (612) 9850 6137] and Dr Rajni Mala [rajni.mala@mq.edu.au, Ph: (612) 9850 8530] of the Department of Accounting and Corporate Governance, Macquarie University, NSW, Australia.

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It is not expected in this study to gather information that represents your views about your work organization or institution, hence, you are not considered as a representative of your work organization or institution. Any information or personal details gathered in the course of the study are confidential, except as required by law. No individual will be identified in any publication of the results. Data will be analysed in aggregate form, held and accessed solely by the researchers (Dr Parmod Chand, Dr Rajni Mala and Dinuja Perera) and will not be used for any other purpose. The results of this study will be incorporated into Dinuja Perera's PhD thesis, which will be available at the Macquarie University Library for public access. A summary of the results of the data can be made available to you on request by emails to the researchers.

It would be greatly appreciated if you could please complete the attached questionnaire. Your time and co-operation in this study will be greatly appreciated. Participation in this survey is entirely voluntary and if you do not wish to participate you may simply not return the questionnaire. Completion and return of the questionnaire will be regarded as consent to use the information for research purposes.[1] You may contact Mr Chaminda Ruwan Thilakarathne [Ph: (94) 112 903 654] in relation to any ethical concerns about this study.

Please answer all questions. Your response is very important for the research which will contribute to understanding factors affecting professional judgment of accountants when interpreting and applying IFRS for SMEs.

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Section 1

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Please respond to the following questions so that a profile for respondents can be developed.

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3.	**In total, how many years of formal education (primary, secondary and tertiary) did you complete?** ☐ Less than 15 years ☐ 15 years ☐ 16 years ☐ 17 years ☐ 18 years or over
4.	**In which country did you complete your:** **Primary education** ___________ **Secondary education** ______________ **Tertiary education** ___________
5.	**Are you a member of:** ICASL ☐ ____________ Other (please specify)
6.	**How many years of professional experience do you have as a qualified accountant?** _______ Years
7.	**In which of the following areas do you specialize or work?** ☐ Accounting ☐ Audit ☐ Tax ☐ Consulting ___________ Other (please specify)
8.	**In which type of firm/organization do you work?** ☐ Big 4 Accounting Firm ☐ Non-Big 4 Accounting Firm ☐ SME (Small & Medium-sized Entity) ____________ Other(please specify)
9.	**How large (in terms of qualified professional accountants) is the firm/organization in which you work?** ☐ 1-5 ☐ 6-20 ☐ 21-100 ☐ Over 100
10.	**How familiar are you with Sri Lankan Financial Reporting Standards (SLAS) equivalents of IASs/IFRSs?** ☐ Very familiar ☐ Familiar ☐ Somewhat familiar ☐ Not familiar
11.	**How frequently do you refer to SLAS equivalents of IASs/IFRSs in your professional practice?** ☐ Often ☐ Sometimes ☐ Seldom ☐ Never
12.	**How familiar are you with SLFRS for SMEs equivalents of IFRS for SMEs?** ☐ Very familiar ☐ Familiar ☐ Somewhat familiar ☐ Not familiar
13.	**How frequently do you refer to SLFRS for SMEs equivalents of IFRS for SMEs in your professional practice?** ☐ Often ☐ Sometimes ☐ Seldom ☐ Never

Section 2

CASE STUDY
Below is a scenario and requires a judgment regarding the appropriate method of financial reporting. Please note that by indicating that you agree (or disagree) with the proposed accounting treatment, you will be understood to be disagreeing (or agreeing) with the other treatment. You may refer to the accounting standards in making your judgments.   **You are asked to provide a judgment on the matter by providing a response on the scale 1 to 7 (please indicate by circling the relevant number).**   **You are also required to give a justification on your judgment in writing on the "Judgment Justification Sheet" provided.**   **The required judgment is based on SLFRS for SMEs equivalent of IFRS for SMEs.**

Before attempting the case study provided on the next page, please indicate the extent to which you apply your prior knowledge of SLAS (Sri Lankan Financial Reporting Standards) when interpreting and applying the newly issued SLFRS for SMEs on the following scale.

Not at all			To Some Extent			To a Great Extent
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Case - Recognition of Revenue

"Dream Homes Real Estate" is a medium-sized non-listed company which engages in developing residential real estate and selling individual apartments. During its 10 years of successful business operations, Dream Homes has established an excellent record of being able to fulfill its obligations towards its customers as contracted. The company now prepares the financial statements in accordance with SLFRS for SMEs equivalent of IFRS for SMEs, and the company's financial year ends on 30th June.

At the beginning of 2013, Dream Homes purchased a new plot of land for the construction of individual apartments. It designed an apartment complex to be built on the land and submitted the designs to planning authorities in order to obtain building permissions. Once the designs were approved, Dream Homes started marketing the individual apartments. A buyer entered into an agreement with Dream Homes on 15th January 2013 for the sale of land and the construction of a two bedroom apartment in one of the land plots in the proposed apartment complex. The estimated purchase price of the apartment is LKR 15,000,000. The agreement prohibits the company from transferring the apartment to another customer. Dream Homes acquires all materials required for the construction from its subsidiary company Global Materials Private Limited. The estimated purchase price does not include any interior designing elements of the apartment. The apartment will be ready for occupation by 30th November 2013.

The buyer paid a non-refundable upfront deposit of LKR 2,000,000 on the agreement date for the construction. The buyer is also required to make three progress payments at three stages of completion, between the time of the initial agreement and contractual completion. These progress payments are designed to compensate the company for its performance to date. The buyer is able to specify only minor variations to the basic design. The agreement gives buyer the right to consult and contract with his own interior designers for arranging the interior designing components for each completed elements of the apartment over time. The company is responsible for remedying any minor construction defects detected before the contractual completion. The legal title of the apartment is passed to the buyer on contractual completion.

The company now has to decide whether to recognize revenue of this construction agreement using either stage of completion using the percentage of completion method or the completed contract method (i.e. on delivery of the completed real estate to the buyer at the end of the contract).

The Accountant "Y" who works for Dream Homes Real Estate holds the view that "the company can recognize the revenue of this construction agreement by reference to the stage of completion using the percentage of completion method as construction of this apartment progresses".

Record your judgment on Accountant Y's view that the company can recognize the revenue of this agreement using the percentage of completion method.

You are also required to give a justification on your judgment in writing on the "Judgment Justification Sheet" provided below. Some of you may be chosen at random to further explain and justify your judgment to the researcher.

Case	**Strongly Disagree**						**Strongly Agree**
Judgment	1	2	3	4	5	6	7

JUSTIFICATION SHEET

Please provide a justification for your judgment above as to why you are agreeing/disagreeing with the proposed accounting treatment. In making your justification please provide your reason(s) for choosing your accounting treatment.

Please place a tick in the appropriate box where 1 denotes that the recognition criterion was irrelevant and 10 denotes that the criterion was relevant in making the above judgment.

Criteria	Irrelevant 1	2	3	4	5	6	7	8	9	Relevant 10
1. If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver the real estate to the buyer, the agreement is an agreement for the sale of goods and the criteria for recognition of revenue apply.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
2. In an agreement for the sale of goods the entity may transfer to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
3. In an agreement for the sale of goods if all criteria for recognition of revenue are met continuously as construction progresses, the entity shall recognise revenue by reference to the stage of completion using the percentage of completion method.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
4. An entity that undertakes the construction of real estate and enters into an agreement with one or more buyers before construction is complete, shall account for the agreement as a sale of services, using the percentage of completion method if the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
5. The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
6. If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver the real estate to the buyer, the agreement is an agreement for the sale of goods but the buyer does not obtain control or the significant risks and rewards of ownership of the work in progress in its current state as construction progresses.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
7. It is probable that the economic benefits associated with the transaction will flow to the entity.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
8. An entity that undertakes the construction of real estate and enters into an agreement with one or more buyers before construction is complete, shall account for the agreement as a sale of services, using the percentage of completion method if the buyer acquires and supplies construction materials and the entity provides only construction services.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
9. The costs incurred or to be incurred in respect of the transaction can be measured reliably.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
10. The amount of revenue can be measured reliably.	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

Please indicate the extent to which you applied your prior knowledge of SLAS (Sri Lankan Financial Reporting Standards) to come to an appropriate judgment on this case on the following scale:

Not at All			To Some Extent			To a Great Extent
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate the extent to which the requirement to justify your judgment enabled you to make a better judgment on the following scale:

Not at All			To Some Extent			To a Great Extent
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate how motivated you were to perform well on this case on the following scale:

Not at All			Moderately Motivated			Extremely Motivated
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate how much effort you have expended on this case on the following scale:

Very Little Effort			Moderate Effort			A Great Deal of Effort
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate the level of complexity of this case on the following scale:

Not Complex			Moderately Complex			Extremely Complex
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate your level of familiarity in dealing with similar cases like this on the following scale:

Not Familiar			Moderately Familiar			Very Familiar
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please record the approximate time you spent to complete this survey:

Time Spent: ☐

Thank you for taking the time to complete this instrument. Your assistance is very much appreciated. If you have any further comments, please provide them in the space provided.

Please ensure that you have answered every question. Missing questions will mean all of your responses are unusable.

Dinuja Perera
Department of Accounting and Corporate Governance
Faculty of Business and Economics
Macquarie University
NSW 2109
Australia.

Thank you for your participation!

(Version 3 – With Decision Aid)

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Participant Information Form

Factors Affecting Professional Judgment of Accountants

Supervisors: Dr Parmod Chand and Dr Rajni Mala

You are invited to participate in a study of judgment in accounting. The purpose of this study is to examine the factors affecting professional judgment of accountants when they interpret and apply the Sri Lankan Financial Reporting Standards (SLFRS) for Small and Medium-Sized Enterprises (SMEs), the equivalent of International Financial Reporting Standards (IFRS) for SMEs.

The study is being conducted by Dinuja Perera [Department of Accounting and Corporate Governance, dinuja.perera@mq.edu.au, Ph: (61) 414 729 623]. It is being conducted to meet the requirements of Doctor of Philosophy in Accounting and Corporate Governance under the supervision of Dr Parmod Chand [parmod.chand@mq.edu.au, Ph: (612) 9850 6137] and Dr Rajni Mala [rajni.mala@mq.edu.au, Ph: (612) 9850 8530] of the Department of Accounting and Corporate Governance, Macquarie University, NSW, Australia.

If you decide to participate, you will be asked to complete the questionnaire. The questionnaire is in two parts. Part one collects demographic data about the respondents. Part two consists of a small case study, and you are asked to provide your judgment on a scenario concerning a problem regarding appropriate financial reporting. It will take approximately 20-25 minutes to complete the questionnaire.

It is not expected in this study to gather information that represents your views about your work organization or institution, hence, you are not considered as a representative of your work organization or institution. Any information or personal details gathered in the course of the study are confidential, except as required by law. No individual will be identified in any publication of the results. Data will be analysed in aggregate form, held and accessed solely by the researchers (Dr Parmod Chand, Dr Rajni Mala and Dinuja Perera) and will not be used for any other purpose. The results of this study will be incorporated into Dinuja Perera's PhD thesis, which will be available at the Macquarie University Library for public access. A summary of the results of the data can be made available to you on request by emails to the researchers.

It would be greatly appreciated if you could please complete the attached questionnaire. Your time and co-operation in this study will be greatly appreciated. Participation in this survey is entirely voluntary and if you do not wish to participate you may simply not return the questionnaire. Completion and return of the questionnaire will be regarded as consent to use the information for research purposes.[1] You may contact Mr Chaminda Ruwan Thilakarathne [Ph: (94) 112 903 654] in relation to any ethical concerns about this study.

Please answer all questions. Your response is very important for the research which will contribute to understanding factors affecting professional judgment of accountants when interpreting and applying IFRS for SMEs.

[1] The ethical aspects of this study have been approved by the Macquarie University Human Research Ethics Committee. If you have any complaints or reservations about any ethical aspect of your participation in this research, you may contact the Committee through the Director, Research Ethics (telephone [02] 9850 7854, email: ethics@mq.edu.au). Any complaint you make will be treated in confidence and investigated, and you will be informed of the outcome.

Section 1

YOUR PERSONAL PROFILE

Please respond to the following questions so that a profile for respondents can be developed.

1.	**Are you:** Male ☐ Female ☐
2.	**How old are you**? ☐ Under 20 years ☐ 20-24 ☐ 25-29 ☐ 30-34 ☐ 35-39 ☐ 40-49 ☐ 50-59 ☐ 60 or over
3.	**In total, how many years of formal education (primary, secondary and tertiary) did you complete?** ☐ Less than 15 years ☐ 15 years ☐ 16 years ☐ 17 years ☐ 18 years or over
4.	**In which country did you complete your:** **Primary education** ___________ **Secondary education** ______________ **Tertiary education** ___________
5.	**Are you a member of:** ICASL ☐ ____________ Other (please specify)
6.	**How many years of professional experience do you have as a qualified accountant?** _______ Years
7.	**In which of the following areas do you specialize or work?** ☐ Accounting ☐ Audit ☐ Tax ☐ Consulting ____________ Other (please specify)
8.	**In which type of firm/organization do you work?** ☐ Big 4 Accounting Firm ☐ Non-Big 4 Accounting Firm ☐ SME (Small & Medium-sized Entity) ____________ Other(please specify)
9.	**How large (in terms of qualified professional accountants) is the firm/organization in which you work?** ☐ 1-5 ☐ 6-20 ☐ 21-100 ☐ Over 100
10.	**How familiar are you with Sri Lankan Financial Reporting Standards (SLAS) equivalents of IASs/IFRSs?** ☐ Very familiar ☐ Familiar ☐ Somewhat familiar ☐ Not familiar
11.	**How frequently do you refer to SLAS equivalents of IASs/IFRSs in your professional practice?** ☐ Often ☐ Sometimes ☐ Seldom ☐ Never
12.	**How familiar are you with SLFRS for SMEs equivalents of IFRS for SMEs?** ☐ Very familiar ☐ Familiar ☐ Somewhat familiar ☐ Not familiar
13.	**How frequently do you refer to SLFRS for SMEs equivalents of IFRS for SMEs in your professional practice?** ☐ Often ☐ Sometimes ☐ Seldom ☐ Never

Section 2

CASE STUDY

Below is a scenario and requires a judgment regarding the appropriate method of financial reporting. Please note that by indicating that you agree (or disagree) with the proposed accounting treatment, you will be understood to be disagreeing (or agreeing) with the other treatment. You may refer to the accounting standards in making your judgments.

You are asked to provide a judgment on the matter by providing a response on the scale 1 to 7 (please indicate by circling the relevant number).

The required judgment is based on SLFRS for SMEs equivalent of IFRS for SMEs.

You may refer to the decision aid provided which outlines further interpretation guidance on IFRS for SMEs that may assist you in making your judgment.

Before attempting the case study provided on the next page, please indicate the extent to which you apply your prior knowledge of SLAS (Sri Lankan Financial Reporting Standards) when interpreting and applying the newly issued SLFRS for SMEs on the following scale.

Not at all			To Some Extent			To a Great Extent
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

DECISION AID

The following interpretation guidance provides you information related to accounting for revenue from the construction of real estate (IFRIC 15 of full IFRS and SLFRS for SMEs). You may refer to this decision aid in making your judgment.

Full IFRS

The interpretations in IFRIC 15 – Agreement for the Construction of Real Estate applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors.

The SLFRS for SMEs (equivalent of IFRS for SMEs) is completely stand-alone document.

The Section 23 (Revenue) of SLFRS for SMEs provides simplified guidance as examples that focus on particular aspects of transactions, including the Agreements for the construction of real estate.

IFRIC 15 (Full IFRS)	SLFRS for SMEs
The agreement is an agreement for the rendering of services	
If the entity is not required to acquire and supply construction materials, the agreement may be only an agreement for the rendering of services in accordance with IAS 18. In this case, if the criteria in paragraph 20 of IAS 18 are met, IAS 18 requires revenue to be recognised by reference to the stage of completion of the transaction using the percentage of completion method. The requirements of IAS 11 are generally applicable to the recognition of revenue and the associated expenses for such a transaction (IAS 18 paragraph 21).	An entity that undertakes the construction of real estate, directly or through subcontractors, and enters into an agreement with one or more buyers before construction is complete, shall account for the agreement as a sale of services, using the percentage of completion method, only if: (a) the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (whether it exercises that ability or not), or (b) the buyer acquires and supplies construction materials and the entity provides only construction services.
The agreement is an agreement for the sale of goods	
a) If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver the real estate to the buyer, the agreement is an agreement for the sale of goods and the criteria for recognition of revenue set out in paragraph 14 of IAS 18 apply b) The entity may transfer to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. In this case, if all the criteria in paragraph 14 of IAS 18 are met continuously as construction progresses, the entity shall recognise revenue by reference to the stage of completion using the percentage of completion method. The requirements of IAS 11 are generally applicable to the recognition of revenue and the associated expenses for such a transaction. c) The entity may transfer to the buyer control and the significant risks and rewards of ownership of the real estate in its entirety at a single time (e.g. at completion, upon or after delivery). In this case, the entity shall recognise revenue only when all the criteria in paragraph 14 of IAS 18 are satisfied.	If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver real estate to the buyer, the agreement shall be accounted for as the sale of goods. In this case, the buyer does not obtain control or the significant risks and rewards of ownership of the work in progress in its current state as construction progresses. Rather, the transfer occurs only on delivery of the completed real estate to the buyer.

Case - Recognition of Revenue

"Dream Homes Real Estate" is a medium-sized non-listed company which engages in developing residential real estate and selling individual apartments. During its 10 years of successful business operations, Dream Homes has established an excellent record of being able to fulfill its obligations towards its customers as contracted. The company now prepares the financial statements in accordance with SLFRS for SMEs equivalent of IFRS for SMEs, and the company's financial year ends on 30th June.

At the beginning of 2013, Dream Homes purchased a new plot of land for the construction of individual apartments. It designed an apartment complex to be built on the land and submitted the designs to planning authorities in order to obtain building permissions. Once the designs were approved, Dream Homes started marketing the individual apartments. A buyer entered into an agreement with Dream Homes on 15th January 2013 for the sale of land and the construction of a two bedroom apartment in one of the land plots in the proposed apartment complex. The estimated purchase price of the apartment is LKR 15,000,000. The agreement prohibits the company from transferring the apartment to another customer. Dream Homes acquires all materials required for the construction from its subsidiary company Global Materials Private Limited. The estimated purchase price does not include any interior designing elements of the apartment. The apartment will be ready for occupation by 30th November 2013.

The buyer paid a non-refundable upfront deposit of LKR 2,000,000 on the agreement date for the construction. The buyer is also required to make three progress payments at three stages of completion, between the time of the initial agreement and contractual completion. These progress payments are designed to compensate the company for its performance to date. The buyer is able to specify only minor variations to the basic design. The agreement gives buyer the right to consult and contract with his own interior designers for arranging the interior designing components for each completed elements of the apartment over time. The company is responsible for remedying any minor construction defects detected before the contractual completion. The legal title of the apartment is passed to the buyer on contractual completion.

The company now has to decide whether to recognize revenue of this construction agreement using either stage of completion using the percentage of completion method or the completed contract method (i.e. on delivery of the completed real estate to the buyer at the end of the contract).

The Accountant "Y" who works for Dream Homes Real Estate holds the view that "the company can recognize the revenue of this construction agreement by reference to the stage of completion using the percentage of completion method as construction of this apartment progresses".

Record your judgment on Accountant Y's view that the company can recognize the revenue of this agreement using the percentage of completion method.

Case	**Strongly Disagree**						**Strongly Agree**
Judgment	1	2	3	4	5	6	7

Please place a tick in the appropriate box where 1 denotes that the recognition criterion was irrelevant and 10 denotes that the criterion was relevant in making the above judgment.

Criteria	**Irrelevant** … **Relevant**
1. If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver the real estate to the buyer, the agreement is an agreement for the sale of goods and the criteria for recognition of revenue apply.	1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐ 6 ☐ 7 ☐ 8 ☐ 9 ☐ 10 ☐
2. In an agreement for the sale of goods the entity may transfer to the buyer control and the significant risks and rewards of ownership of the work in progress in its current state as construction progresses.	1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐ 6 ☐ 7 ☐ 8 ☐ 9 ☐ 10 ☐
3. In an agreement for the sale of goods if all criteria for recognition of revenue are met continuously as construction progresses, the entity shall recognise revenue by reference to the stage of completion using the percentage of completion method.	1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐ 6 ☐ 7 ☐ 8 ☐ 9 ☐ 10 ☐
4. An entity that undertakes the construction of real estate and enters into an agreement with one or more buyers before construction is complete, shall account for the agreement as a sale of services, using the percentage of completion method if the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress.	1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐ 6 ☐ 7 ☐ 8 ☐ 9 ☐ 10 ☐
5. The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold.	1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐ 6 ☐ 7 ☐ 8 ☐ 9 ☐ 10 ☐
6. If the entity is required to provide services together with construction materials in order to perform its contractual obligation to deliver the real estate to the buyer, the agreement is an agreement for the sale of goods but the buyer does not obtain control or the significant risks and rewards of ownership of the work in progress in its current state as construction progresses.	1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐ 6 ☐ 7 ☐ 8 ☐ 9 ☐ 10 ☐
7. It is probable that the economic benefits associated with the transaction will flow to the entity.	1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐ 6 ☐ 7 ☐ 8 ☐ 9 ☐ 10 ☐
8. An entity that undertakes the construction of real estate and enters into an agreement with one or more buyers before construction is complete, shall account for the agreement as a sale of services, using the percentage of completion method if the buyer acquires and supplies construction materials and the entity provides only construction services.	1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐ 6 ☐ 7 ☐ 8 ☐ 9 ☐ 10 ☐
9. The costs incurred or to be incurred in respect of the transaction can be measured reliably.	1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐ 6 ☐ 7 ☐ 8 ☐ 9 ☐ 10 ☐
10. The amount of revenue can be measured reliably.	1 ☐ 2 ☐ 3 ☐ 4 ☐ 5 ☐ 6 ☐ 7 ☐ 8 ☐ 9 ☐ 10 ☐

Please indicate the extent to which you applied your prior knowledge of SLAS (Sri Lankan Financial Reporting Standards) to come to an appropriate judgment on this case on the following scale:

Not at All			To Some Extent			To a Great Extent
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate the extent to which the decision aid clarified the differences between SLAS requirements and the requirements of SLFRS for SMEs on the following scale:

Did not Clarify at All			Clarified to Some Extent			Clarified to a Great Extent
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate the extent to which the decision aid enabled you to make a better judgment on the following scale:

Not at All			To Some Extent			To a Great Extent
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate how motivated you were to perform well on this case on the following scale:

Not at All			Moderately Motivated			Extremely Motivated
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate how much effort you have expended on this case on the following scale:

Very Little Effort			Moderate Effort			A Great Deal of Effort
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate the level of complexity of this case on the following scale:

Not Complex			Moderately Complex			Extremely Complex
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate your level of familiarity in dealing with similar cases like this on the following scale:

Not Familiar			Moderately Familiar			Very Familiar
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please record the approximate time you spent to complete this survey:

Time Spent: ☐

Thank you for taking the time to complete this instrument. Your assistance is very much appreciated. If you have any further comments, please provide them in the space provided.

Please ensure that you have answered every question. Missing questions will mean all of your responses are unusable.

Dinuja Perera
Department of Accounting and Corporate Governance
Faculty of Business and Economics
Macquarie University
NSW 2109
Australia.

Thank you for your participation!

APPENDIX 3

Research Instrument – Paper 3

(Version 1 – With IFRS for SMEs Guidance)

Department of Accounting and Corporate Governance
Faculty of Business and Economics
Macquarie University NSW 2109
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Email: parmod.chand@mq.edu.au

Participant Information Form

The Impact of Guidance in IFRS for SMEs on the Professional Judgments of Accountants

Supervisors: Associate Professor Parmod Chand and Dr Rajni Mala

You are invited to participate in a study which investigates judgments made by accountants. This study aims to examine the effects of guidance in International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs) on the professional judgments of accountants.

The study is being conducted by Dinuja Perera [Department of Accounting and Corporate Governance, Macquarie University, NSW, Australia, dinuja.perera@mq.edu.au, Ph: (61) 414 729 623] to meet the requirements of Doctor of Philosophy under the supervision of Associate Professor Parmod Chand [parmod.chand@mq.edu.au, Ph: (612) 9850 6137] and Dr Rajni Mala [rajni.mala@mq.edu.au, Ph: (612) 9850 8530] of the Department of Accounting and Corporate Governance, Macquarie University.

If you decide to participate, you will be asked to complete a questionnaire. The questionnaire has two parts. Part one collects demographic data about the respondents. Part two consists of a small case study, and you are asked to provide your judgment on one scenario concerning a problem regarding appropriate financial reporting. It will take approximately 20-25 minutes to complete the questionnaire.

As you participate in this study as an individual, you are not considered to be a representative of your work organization or institution. The information provided by you represents your personal views only and not the views of your workplace. No sensitive personal information will be collected. Any information or personal details gathered in this study are confidential, except as required by law. No individual will be identified in any publication of the results. Data will be analysed in aggregate form, held and accessed solely by the researchers (Associate Professor Parmod Chand, Dr Rajni Mala and Dinuja Perera) and will not be used for any other purpose. The results of this study will be incorporated into Dinuja Perera's PhD thesis, which will be available at the Macquarie University Library for public access. A summary of the research results data can be made available to you on request by email to the researchers.

Participation in this survey is entirely voluntary. If you could complete the attached questionnaire, your time and co-operation will be greatly appreciated. If you do not wish to participate, simply do not return the questionnaire. Please note that completion and return of the questionnaire will be regarded as consent to use the information for research purposes.[1]

Please answer all questions. Your response is very important for the research which will contribute to understanding the effects of guidance in IFRS for SMEs on the professional judgments of accountants.

[1] The ethical aspects of this study have been approved by the Macquarie University Human Research Ethics Committee. If you have any complaints or reservations about any ethical aspect of your participation in this research, you may contact the Committee through the Director, Research Ethics (telephone [02] 9850 7854, email: ethics@mq.edu.au). Any complaint you make will be treated in confidence and investigated, and you will be informed of the outcome. The local contact person is Professor Michael White [michael.white @usp.ac.fj].

Section 1

YOUR PERSONAL PROFILE

Please respond to the following questions so that a profile for respondents can be developed.

1.	**Are you:** Male ☐ Female ☐
2.	**How old are you?** ☐ Under 20 years ☐ 20-24 ☐ 25-29 ☐ 30-34 ☐ 35-39 ☐ 40-49 ☐ 50-59 ☐ 60 or over
3.	**In total, how many years of formal education (primary, secondary and tertiary) did you complete?** ☐ Less than 15 years ☐ 15 years ☐ 16 years ☐ 17 years ☐ 18 years or over
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5.	**Are you a member of:** FIA? ☐ ____________ (Please state membership status) ____________ Other (please specify)
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7.	**In which of the following areas do you specialize or work?** ☐ Accounting ☐ Audit ☐ Tax ☐ Consulting ___________ Other (please specify)
8.	**In which type of firm/organization do you work?** ☐ Big 4 Accounting Firm ☐ Non-Big 4 Accounting Firm ____________ Other (please specify)
9.	**How large (in terms of qualified professional accountants) is the firm/organization in which you work?** ☐ 1-5 FIA/CPAs/CAs ☐ 6-20 FIA/CPAs/CAs ☐ 21-100 FIA/CPAs/CAs ☐ Over 100 FIA/CPAs/CAs
10.	**How familiar are you with International Financial Reporting Standards (IFRS)?** ☐ Very familiar ☐ Familiar ☐ Not Sure ☐ Unfamiliar ☐ Very unfamiliar
11.	**How frequently do you refer to IFRS in your professional practice?** ☐ Always ☐ Often ☐ Sometimes ☐ Rarely ☐ Never
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Section 2

CASE STUDY
Below is a scenario that requires your judgment regarding the appropriate method of financial reporting. Please note that by indicating that you agree (or disagree) with the proposed accounting treatment, it means you also disagree (or agree) with the other treatment. You may refer to the accounting standards while making your judgments. **You are asked to provide a judgment on the matter by providing a response on the scale 1 to 7 (please indicate by circling the relevant number).** **The required judgment is based on IFRS for SMEs.** **You may refer to the following guidance provided on IFRS for SMEs that may assist you in making your judgment.**

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• If an investor holds, directly or indirectly (eg through subsidiaries), 20 per cent or more of the voting power of the associate, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case. • Conversely, if the investor holds, directly or indirectly (eg through subsidiaries), less than 20 per cent of the voting power of the associate, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated. • A substantial or majority ownership by another investor does not preclude an investor from having significant influence.

Case – Investments in Associates

A medium-sized non-listed company, Max Ltd, is a wholesaler of automotive spare parts to a range of independent retailers and is the sole distributor for three major brands in the market (GT GAS, Ultima and Supercharge). Max Ltd holds 15% share of the country's automotive spare part market. In line with its new market strategy to diversify its operations, in July 2012, Max Ltd acquired full stake in Acme Ltd, a retail chain of hardware stores. Max Ltd prepares the financial statements in accordance with IFRS for SMEs, and the company's financial year ends on 30th June.

- During January 2013, Acme Ltd acquired 10% interest in the common stock of Logo Ltd, a retail chain in the automotive spare part market, operating in most provinces. In July 2013, Max Ltd acquired 8% interest in the common stock of Logo Ltd, with the intention of utilising proceeds from dividends to meet the expenses of the '7 Year Debentures' issued in April 2013 for its expansion project.
- As at 30 June 2014, the majority shareholder of Logo Ltd held 62% of common stock, while the second largest shareholder held 20% of common stocks. The remainder was held by Acme Ltd and Max Ltd.
- The Board of Directors of Logo Ltd consists of ten members. The majority shareholder was represented by six of the Board members, while the second largest shareholder was represented by two members. Max Ltd and Acme Ltd were represented by one member each. The Board makes decisions on the basis of a simple majority. The two Board members representing Max Ltd and Acme Ltd are fully engaged in their own business operations. The Board meetings of Logo Ltd are often held at very short notice. As such, Max Ltd and Acme Ltd Board representation is not available for most of the Board meetings of Logo Ltd.
- During the financial year ending 30 June 2014, Logo Ltd has purchased \$4 million worth of spare parts on arms-length basis from its supplier base, out of which 25% was from Max Ltd. Logo Ltd's total turnover for the period is \$9.35 million, recording a significant growth from last year's turnover of \$4.3 million. 30% of this growth has been achieved from 'GT GAS' and 'Supercharge' brands.
- Max Ltd offers a strong marketing support and a wide range of retail services to its independent retailer network, including Logo Ltd by providing advisory and coaching on the marketing strategy to ensure greater customer satisfaction.

The accountant X who works for Max Ltd is of the view that "Max Ltd can account for its investment in Logo Ltd as an associate, because Max Ltd has the ability to exert significant influence over Logo Ltd".

By applying IFRS for SMEs and the guidance provided, record your judgment on Accountant X's view that Logo Ltd can be treated as an associate of Max Ltd.

Case	Strongly Disagree					Strongly Agree
Judgment	1	2	3	4	5	6	7

Please indicate the level of help the guidance provided in making your judgment on the following scale:

Not at all Helpful			Of Some Help			Extremely Helpful
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate the extent to which the guidance provided enabled you to make a better judgment on the following scale:

Not at All			To Some Extent			To a Great Extent
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate the extent to which you require additional guidance in IFRS for SMEs in making accurate judgments on an ongoing basis on the following scale:

Not at All			To Some Extent			To a Great Extent
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate how motivated you were to perform well on this case on the following scale:

Not at All			Moderately Motivated			Extremely Motivated
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate how much effort you have expended on this case on the following scale:

Very Little Effort			Moderate Effort			A Great Deal of Effort
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☐	☐	☐	☐	☐	☐	☐

Please indicate the level of complexity of this case on the following scale:

Not Complex			Moderately Complex			Extremely Complex
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☐	☐	☐	☐	☐	☐	☐

Please indicate your level of familiarity in dealing with similar cases like this on the following scale:

Not Familiar			Moderately Familiar			Very Familiar
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☐	☐	☐	☐	☐	☐	☐

Thank you for taking the time to complete this instrument. Your assistance is very much appreciated. If you have any further comments, please provide them in the space provided.

Please make sure that you have answered every question. Missing questions will mean that all of your responses cannot be used.

Dinuja Perera
Department of Accounting and Corporate Governance
Faculty of Business and Economics
Macquarie University
NSW 2109
Australia

Thank you very much for your participation!

(Version 2 – With Full IFRS Guidance)

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Participant Information Form

The Impact of Guidance in IFRS for SMEs on the Professional Judgments of Accountants

Supervisors: Associate Professor Parmod Chand and Dr Rajni Mala

You are invited to participate in a study which investigates judgments made by accountants. This study aims to examine the effects of guidance in International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs) on the professional judgments of accountants.

The study is being conducted by Dinuja Perera [Department of Accounting and Corporate Governance, Macquarie University, NSW, Australia, dinuja.perera@mq.edu.au, Ph: (61) 414 729 623] to meet the requirements of Doctor of Philosophy under the supervision of Associate Professor Parmod Chand [parmod.chand@mq.edu.au, Ph: (612) 9850 6137] and Dr Rajni Mala [rajni.mala@mq.edu.au, Ph: (612) 9850 8530] of the Department of Accounting and Corporate Governance, Macquarie University.

If you decide to participate, you will be asked to complete a questionnaire. The questionnaire has two parts. Part one collects demographic data about the respondents. Part two consists of a small case study, and you are asked to provide your judgment on one scenario concerning a problem regarding appropriate financial reporting. It will take approximately 20-25 minutes to complete the questionnaire.

As you participate in this study as an individual, you are not considered to be a representative of your work organization or institution. The information provided by you represents your personal views only and not the views of your workplace. No sensitive personal information will be collected. Any information or personal details gathered in this study are confidential, except as required by law. No individual will be identified in any publication of the results. Data will be analysed in aggregate form, held and accessed solely by the researchers (Associate Professor Parmod Chand, Dr Rajni Mala and Dinuja Perera) and will not be used for any other purpose. The results of this study will be incorporated into Dinuja Perera's PhD thesis, which will be available at the Macquarie University Library for public access. A summary of the research results data can be made available to you on request by email to the researchers.

Participation in this survey is entirely voluntary. If you could complete the attached questionnaire, your time and co-operation will be greatly appreciated. If you do not wish to participate, simply do not return the questionnaire. Please note that completion and return of the questionnaire will be regarded as consent to use the information for research purposes.[1]

Please answer all questions. Your response is very important for the research which will contribute to understanding the effects of guidance in IFRS for SMEs on the professional judgments of accountants.

[1] The ethical aspects of this study have been approved by the Macquarie University Human Research Ethics Committee. If you have any complaints or reservations about any ethical aspect of your participation in this research, you may contact the Committee through the Director, Research Ethics (telephone [02] 9850 7854, email: ethics@mq.edu.au). Any complaint you make will be treated in confidence and investigated, and you will be informed of the outcome. The local contact person is Professor Michael White [michael.white @usp.ac.fj].

Section 1

YOUR PERSONAL PROFILE

Please respond to the following questions so that a profile for respondents can be developed.

1.	**Are you:** Male ☐ Female ☐
2.	**How old are you?** ☐ Under 20 years ☐ 20-24 ☐ 25-29 ☐ 30-34 ☐ 35-39 ☐ 40-49 ☐ 50-59 ☐ 60 or over
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CASE STUDY

Below is a scenario that requires your judgment regarding the appropriate method of financial reporting. Please note that by indicating that you agree (or disagree) with the proposed accounting treatment, it means you also disagree (or agree) with the other treatment. You may refer to the accounting standards while making your judgments.

You are asked to provide a judgment on the matter by providing a response on the scale 1 to 7 (please indicate by circling the relevant number).

The required judgment is based on IFRS for SMEs.

You may refer to the following guidance provided that may assist you in making your judgment.

The following guidance provides information in making a judgment on whether an entity has significant influence over another entity [Paragraphs 14.3 (a, b, and c) of Section 14 – *Investments in Associates* of IFRS for SMEs]. You may refer to this guidance while making your judgment on the scenario.

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You may further refer to the following additional guidance provided in Paragraphs 6 to 9 of IAS 28 – *Investments in Associates and Joint Ventures* of IFRS while making your judgment on the scenario.

- The existence of significant influence by an entity is usually evidenced in one or more of the following ways:
  a) representation on the board of directors or equivalent governing body of the investee;
  b) participation in policy-making processes, including participation in decisions about dividends or other distributions;
  c) material transactions between the entity and its investee;
  d) interchange of managerial personnel; or
  e) provision of essential technical information.
- An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the entity additional voting power or to reduce another party's voting power over the financial and operating policies of another entity (i.e. potential voting rights). The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other entities, are considered when assessing whether an entity has significant influence. Potential voting rights are not currently exercisable or convertible when, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event.
- In assessing whether potential voting rights contribute to significant influence, the entity examines all facts and circumstances (including the terms of exercise of the potential voting rights and any other contractual arrangements whether considered individually or in combination) that affect potential rights, except the intentions of management and the financial ability to exercise or convert those potential rights.
- An entity loses significant influence over an investee when it loses the power to participate in the financial and operating policy decisions of that investee. The loss of significant influence can occur with or without a change in absolute or relative ownership levels. It could occur, for example, when an associate becomes subject to the control of a government, court, administrator or regulator. It could also occur as a result of a contractual arrangement.

Case – Investments in Associates

A medium-sized non-listed company, Max Ltd, is a wholesaler of automotive spare parts to a range of independent retailers and is the sole distributor for three major brands in the market (GT GAS, Ultima and Supercharge). Max Ltd holds 15% share of the country's automotive spare part market. In line with its new market strategy to diversify its operations, in July 2012, Max Ltd acquired full stake in Acme Ltd, a retail chain of hardware stores. Max Ltd prepares the financial statements in accordance with IFRS for SMEs, and the company's financial year ends on 30th June.

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The accountant X who works for Max Ltd is of the view that "Max Ltd can account for its investment in Logo Ltd as an associate, because Max Ltd has the ability to exert significant influence over Logo Ltd".

By applying IFRS for SMEs and the guidance provided, record your judgment on Accountant X's view that Logo Ltd can be treated as an associate of Max Ltd.

Case	Strongly Disagree						Strongly Agree
Judgment	1	2	3	4	5	6	7

Please indicate the level of help the guidance provided in making your judgment on the following scale:

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NSW 2109
Australia

Thank you very much for your participation!

(Version 3 – With Affirmative Example)

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Participant Information Form

The Impact of Guidance in IFRS for SMEs on the Professional Judgments of Accountants

Supervisors: Associate Professor Parmod Chand and Dr Rajni Mala

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Participation in this survey is entirely voluntary. If you could complete the attached questionnaire, your time and co-operation will be greatly appreciated. If you do not wish to participate, simply do not return the questionnaire. Please note that completion and return of the questionnaire will be regarded as consent to use the information for research purposes.[1]

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Section 1

YOUR PERSONAL PROFILE

Please respond to the following questions so that a profile for respondents can be developed.

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10.	**How familiar are you with International Financial Reporting Standards (IFRS)?** ☐ Very familiar ☐ Familiar ☐ Not Sure ☐ Unfamiliar ☐ Very unfamiliar
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Section 2

CASE STUDY

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You are asked to provide a judgment on the matter by providing a response on the scale 1 to 7 (please indicate by circling the relevant number).

The required judgment is based on IFRS for SMEs.

You may refer to the example provided as guidance that may assist you in making your judgment.

Case – Investments in Associates

A medium-sized non-listed company, Max Ltd, is a wholesaler of automotive spare parts to a range of independent retailers and is the sole distributor for three major brands in the market (GT GAS, Ultima and Supercharge). Max Ltd holds 15% share of the country's automotive spare part market. In line with its new market strategy to diversify its operations, in July 2012, Max Ltd acquired full stake in Acme Ltd, a retail chain of hardware stores. Max Ltd prepares the financial statements in accordance with IFRS for SMEs, and the company's financial year ends on 30th June.

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The accountant X who works for Max Ltd is of the view that "Max Ltd can account for its investment in Logo Ltd as an associate, because Max Ltd has the ability to exert significant influence over Logo Ltd".

Assume that the following example is provided as guidance in making the judgment.

Example

It is likely that significant influence exists and there is an associate relationship for the following example.

Entity A was one of the three shareholder's in a regional airport, Entity B.

- As at 30 June 2014, the majority shareholder held 62% of voting shares, the second shareholder held 20% of voting shares and Entity A held 18% of the voting shares in Entity B.
- Entity B's Board of Directors consisted of ten members. The majority shareholder was represented by six of the Board members, while Entity A and the other shareholder were represented by two members each. A shareholders' agreement stated that certain Board and shareholder resolutions required either unanimous or majority decision. There is no indication that the majority shareholder and the other shareholders act together in a common way.
- During the financial year ending June 2014, Entity A had provided Entity B with maintenance and technical services and had sold Entity B a software licence for $4 million.
- Additionally, Entity A had sent a team of management experts to give business advice to the Board of Entity B.

Entity A appears to have significant influence over Entity B, and therefore, it should be accounted for as an associate.

By applying IFRS for SMEs and the example provided, record your judgment on Accountant X's view that Logo Ltd can be treated as an associate of Max Ltd.

Case	**Strongly Disagree**						**Strongly Agree**
Judgment	1	2	3	4	5	6	7

Please indicate the level of help the example provided in making your judgment on the following scale:

Not at all Helpful			Of Some Help			Extremely Helpful
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate the extent to which the example provided enabled you to make a better judgment on the following scale:

Not at All			To Some Extent			To a Great Extent
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate how motivated you were to perform well on this case on the following scale:

Not at All			Moderately Motivated			Extremely Motivated
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate how much effort you have expended on this case on the following scale:

Very Little Effort			Moderate Effort			A Great Deal of Effort
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate the level of complexity of this case on the following scale:

Not Complex			Moderately Complex			Extremely Complex
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate your level of familiarity in dealing with similar cases like this on the following scale:

Not Familiar			Moderately Familiar			Very Familiar
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Thank you for taking the time to complete this instrument. Your assistance is very much appreciated. If you have any further comments, please provide them in the space provided.

Please make sure that you have <u>answered every question</u>. Missing questions will mean that all of your responses cannot be used.

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Thank you very much for your participation!

(Version 4 – With Counter Example)

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Participant Information Form

The Impact of Guidance in IFRS for SMEs on the Professional Judgments of Accountants

Supervisors: Associate Professor Parmod Chand and Dr Rajni Mala

You are invited to participate in a study which investigates judgments made by accountants. This study aims to examine the effects of guidance in International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs) on the professional judgments of accountants.

The study is being conducted by Dinuja Perera [Department of Accounting and Corporate Governance, Macquarie University, NSW, Australia, dinuja.perera@mq.edu.au, Ph: (61) 414 729 623] to meet the requirements of Doctor of Philosophy under the supervision of Associate Professor Parmod Chand [parmod.chand@mq.edu.au, Ph: (612) 9850 6137] and Dr Rajni Mala [rajni.mala@mq.edu.au, Ph: (612) 9850 8530] of the Department of Accounting and Corporate Governance, Macquarie University.

If you decide to participate, you will be asked to complete a questionnaire. The questionnaire has two parts. Part one collects demographic data about the respondents. Part two consists of a small case study, and you are asked to provide your judgment on one scenario concerning a problem regarding appropriate financial reporting. It will take approximately 20-25 minutes to complete the questionnaire.

As you participate in this study as an individual, you are not considered to be a representative of your work organization or institution. The information provided by you represents your personal views only and not the views of your workplace. No sensitive personal information will be collected. Any information or personal details gathered in this study are confidential, except as required by law. No individual will be identified in any publication of the results. Data will be analysed in aggregate form, held and accessed solely by the researchers (Associate Professor Parmod Chand, Dr Rajni Mala and Dinuja Perera) and will not be used for any other purpose. The results of this study will be incorporated into Dinuja Perera's PhD thesis, which will be available at the Macquarie University Library for public access. A summary of the research results data can be made available to you on request by email to the researchers.

Participation in this survey is entirely voluntary. If you could complete the attached questionnaire, your time and co-operation will be greatly appreciated. If you do not wish to participate, simply do not return the questionnaire. Please note that completion and return of the questionnaire will be regarded as consent to use the information for research purposes.[1]

Please answer all questions. Your response is very important for the research which will contribute to understanding the effects of guidance in IFRS for SMEs on the professional judgments of accountants.

[1] The ethical aspects of this study have been approved by the Macquarie University Human Research Ethics Committee. If you have any complaints or reservations about any ethical aspect of your participation in this research, you may contact the Committee through the Director, Research Ethics (telephone [02] 9850 7854, email: ethics@mq.edu.au). Any complaint you make will be treated in confidence and investigated, and you will be informed of the outcome. The local contact person is Professor Michael White [michael.white @usp.ac.fj].

Section 1

YOUR PERSONAL PROFILE

Please respond to the following questions so that a profile for respondents can be developed.

1.	**Are you:** Male ☐ Female ☐
2.	**How old are you?** ☐ Under 20 years ☐ 20-24 ☐ 25-29 ☐ 30-34 ☐ 35-39 ☐ 40-49 ☐ 50-59 ☐ 60 or over
3.	**In total, how many years of formal education (primary, secondary and tertiary) did you complete?** ☐ Less than 15 years ☐ 15 years ☐ 16 years ☐ 17 years ☐ 18 years or over
4.	**What is your ethnicity?** ☐ Ethnic Fijian ☐ Indo-Fijian ☐ Chinese ________________ Other (please specify)
5.	**Are you a member of:** FIA? ☐ ___________ (Please state membership status) ___________ Other (please specify)
6.	**How many years of professional experience do you have as a qualified FIA/CPA/CA? _______** Years
7.	**In which of the following areas do you specialize or work?** ☐ Accounting ☐ Audit ☐ Tax ☐ Consulting ___________ Other (please specify)
8.	**In which type of firm/organization do you work?** ☐ Big 4 Accounting Firm ☐ Non-Big 4 Accounting Firm ___________ Other (please specify)
9.	**How large (in terms of qualified professional accountants) is the firm/organization in which you work?** ☐ 1-5 FIA/CPAs/CAs ☐ 6-20 FIA/CPAs/CAs ☐ 21-100 FIA/CPAs/CAs ☐ Over 100 FIA/CPAs/CAs
10.	**How familiar are you with International Financial Reporting Standards (IFRS)?** ☐ Very familiar ☐ Familiar ☐ Not Sure ☐ Unfamiliar ☐ Very unfamiliar
11.	**How frequently do you refer to IFRS in your professional practice?** ☐ Always ☐ Often ☐ Sometimes ☐ Rarely ☐ Never
12.	**How familiar are you with Fijian equivalents of IFRS for SMEs?** ☐ Very familiar ☐ Familiar ☐ Not Sure ☐ Unfamiliar ☐ Very unfamiliar
13.	**How frequently do you refer to Fijian equivalents of IFRS for SMEs in your professional practice?** ☐ Always ☐ Often ☐ Sometimes ☐ Rarely ☐ Never

Section 2

CASE STUDY

Below is a scenario that requires your judgment regarding the appropriate method of financial reporting. Please note that by indicating that you agree (or disagree) with the proposed accounting treatment, it means you also disagree (or agree) with the other treatment. You may refer to the accounting standards while making your judgments.

You are asked to provide a judgment on the matter by providing a response on the scale 1 to 7 (please indicate by circling the relevant number).

The required judgment is based on IFRS for SMEs.

You may refer to the example provided as guidance that may assist you in making your judgment.

Case – Investments in Associates

A medium-sized non-listed company, Max Ltd, is a wholesaler of automotive spare parts to a range of independent retailers and is the sole distributor for three major brands in the market (GT GAS, Ultima and Supercharge). Max Ltd holds 15% share of the country's automotive spare part market. In line with its new market strategy to diversify its operations, in July 2012, Max Ltd acquired full stake in Acme Ltd, a retail chain of hardware stores. Max Ltd prepares the financial statements in accordance with IFRS for SMEs, and the company's financial year ends on 30th June.

- During January 2013, Acme Ltd acquired 10% interest in the common stock of Logo Ltd, a retail chain in the automotive spare part market, operating in most provinces. In July 2013, Max Ltd acquired 8% interest in the common stock of Logo Ltd, with the intention of utilising proceeds from dividends to meet the expenses of the '7 Year Debentures' issued in April 2013 for its expansion project.
- As at 30 June 2014, the majority shareholder of Logo Ltd held 62% of common stock, while the second largest shareholder held 20% of common stocks. The remainder was held by Acme Ltd and Max Ltd.
- The Board of Directors of Logo Ltd consists of ten members. The majority shareholder was represented by six of the Board members, while the second largest shareholder was represented by two members. Max Ltd and Acme Ltd were represented by one member each. The Board makes decisions on the basis of a simple majority. The two Board members representing Max Ltd and Acme Ltd are fully engaged in their own business operations. The Board meetings of Logo Ltd are often held at very short notice. As such, Max Ltd and Acme Ltd Board representation is not available for most of the Board meetings of Logo Ltd.
- During the financial year ending 30 June 2014, Logo Ltd has purchased $4 million worth of spare parts on arms-length basis from its supplier base, out of which 25% was from Max Ltd. Logo Ltd's total turnover for the period is $9.35 million, recording a significant growth from last year's turnover of $4.3 million. 30% of this growth has been achieved from 'GT GAS' and 'Supercharge' brands.
- Max Ltd offers a strong marketing support and a wide range of retail services to its independent retailer network, including Logo Ltd by providing advisory and coaching on the marketing strategy to ensure greater customer satisfaction.

The accountant X who works for Max Ltd is of the view that "Max Ltd can account for its investment in Logo Ltd as an associate, because Max Ltd has the ability to exert significant influence over Logo Ltd".

Assume that the following example is provided as guidance in making the judgment.

Example

It is likely that significant influence does not exist and there is no associate relationship for the following example.

Entity X was one of the three shareholders in a garment manufacturing firm, Entity Y.

- As at 30 June 2014, the majority shareholder held 62% of voting shares and the second shareholder held 20% of voting shares in Entity Y. Entity X held 18% of the voting shares in Entity Y.
- Entity Y's Board of Directors consisted of ten members. The majority shareholder was represented by seven of the Board members, while the second largest shareholder was represented by two members. Entity X was represented by one Board member. The Board member of Entity X is always too busy to attend Board meetings. The Board makes decisions on the basis of a simple majority.
- During the financial year ended June 2014, Entity X has made a one-off sale of $4 million worth of computer aided fully integrated designing and manufacturing Machines to Entity Y. With this new technology Entity Y's overall production efficiency increased by almost 30%.
- Entity X had also sent a team of technical experts to give technical support for operating the new machines sold to Entity Y.

Entity X does not appear to have significant influence over Entity Y, and therefore, it should not be accounted for as an associate.

By applying IFRS for SMEs and the example provided, record your judgment on Accountant X's view that Logo Ltd can be treated as an associate of Max Ltd.

Case	**Strongly Disagree**						**Strongly Agree**
Judgment	1	2	3	4	5	6	7

Please indicate the level of help the example provided in making your judgment on the following scale:

Not at all Helpful			Of Some Help			Extremely Helpful
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate the extent to which the example provided enabled you to make a better judgment on the following scale:

Not at All			To Some Extent			To a Great Extent
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate how motivated you were to perform well on this case on the following scale:

Not at All			Moderately Motivated			Extremely Motivated
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate how much effort you have expended on this case on the following scale:

Very Little Effort			Moderate Effort			A Great Deal of Effort
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate the level of complexity of this case on the following scale:

Not Complex			Moderately Complex			Extremely Complex
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Please indicate your level of familiarity in dealing with similar cases like this on the following scale:

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Thank you for taking the time to complete this instrument. Your assistance is very much appreciated. If you have any further comments, please provide them in the space provided.

Please make sure that you have <u>answered every question</u>. Missing questions will mean that all of your responses cannot be used.

Dinuja Perera
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Thank you very much for your participation!

(Version 5 – With All Guidance)

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Participant Information Form

The Impact of Guidance in IFRS for SMEs on the Professional Judgments of Accountants

Supervisors: Associate Professor Parmod Chand and Dr Rajni Mala

You are invited to participate in a study which investigates judgments made by accountants. This study aims to examine the effects of guidance in International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs) on the professional judgments of accountants.

The study is being conducted by Dinuja Perera [Department of Accounting and Corporate Governance, Macquarie University, NSW, Australia, dinuja.perera@mq.edu.au, Ph: (61) 414 729 623] to meet the requirements of Doctor of Philosophy under the supervision of Associate Professor Parmod Chand [parmod.chand@mq.edu.au, Ph: (612) 9850 6137] and Dr Rajni Mala [rajni.mala@mq.edu.au, Ph: (612) 9850 8530] of the Department of Accounting and Corporate Governance, Macquarie University.

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Participation in this survey is entirely voluntary. If you could complete the attached questionnaire, your time and co-operation will be greatly appreciated. If you do not wish to participate, simply do not return the questionnaire. Please note that completion and return of the questionnaire will be regarded as consent to use the information for research purposes.[1]

Please answer all questions. Your response is very important for the research which will contribute to understanding the effects of guidance in IFRS for SMEs on the professional judgments of accountants.

[1] The ethical aspects of this study have been approved by the Macquarie University Human Research Ethics Committee. If you have any complaints or reservations about any ethical aspect of your participation in this research, you may contact the Committee through the Director, Research Ethics (telephone [02] 9850 7854, email: ethics@mq.edu.au). Any complaint you make will be treated in confidence and investigated, and you will be informed of the outcome. The local contact person is Professor Michael White [michael.white @usp.ac.fj].

Section 1

YOUR PERSONAL PROFILE

Please respond to the following questions so that a profile for respondents can be developed.

1.	**Are you:** Male ☐ Female ☐
2.	**How old are you?** ☐ Under 20 years ☐ 20-24 ☐ 25-29 ☐ 30-34 ☐ 35-39 ☐ 40-49 ☐ 50-59 ☐ 60 or over
3.	**In total, how many years of formal education (primary, secondary and tertiary) did you complete?** ☐ Less than 15 years ☐ 15 years ☐ 16 years ☐ 17 years ☐ 18 years or over
4.	**What is your ethnicity?** ☐ Ethnic Fijian ☐ Indo-Fijian ☐ Chinese ____________ Other (please specify)
5.	**Are you a member of:** FIA? ☐ ____________ (Please state membership status) ____________ Other (please specify)
6.	**How many years of professional experience do you have as a qualified FIA/CPA/CA?** _______ Years
7.	**In which of the following areas do you specialize or work?** ☐ Accounting ☐ Audit ☐ Tax ☐ Consulting ____________ Other (please specify)
8.	**In which type of firm/organization do you work?** ☐ Big 4 Accounting Firm ☐ Non-Big 4 Accounting Firm ____________ Other (please specify)
9.	**How large (in terms of qualified professional accountants) is the firm/organization in which you work?** ☐ 1-5 FIA/CPAs/CAs ☐ 6-20 FIA/CPAs/CAs ☐ 21-100 FIA/CPAs/CAs ☐ Over 100 FIA/CPAs/CAs
10.	**How familiar are you with International Financial Reporting Standards (IFRS)?** ☐ Very familiar ☐ Familiar ☐ Not Sure ☐ Unfamiliar ☐ Very unfamiliar
11.	**How frequently do you refer to IFRS in your professional practice?** ☐ Always ☐ Often ☐ Sometimes ☐ Rarely ☐ Never
12.	**How familiar are you with Fijian equivalents of IFRS for SMEs?** ☐ Very familiar ☐ Familiar ☐ Not Sure ☐ Unfamiliar ☐ Very unfamiliar
13.	**How frequently do you refer to Fijian equivalents of IFRS for SMEs in your professional practice?** ☐ Always ☐ Often ☐ Sometimes ☐ Rarely ☐ Never

Section 2

CASE STUDY

Below is a scenario that requires your judgment regarding the appropriate method of financial reporting. Please note that by indicating that you agree (or disagree) with the proposed accounting treatment, it means you also disagree (or agree) with the other treatment. You may refer to the accounting standards while making your judgments.

You are asked to provide a judgment on the matter by providing a response on the scale 1 to 7 (please indicate by circling the relevant number).

The required judgment is based on IFRS for SMEs.

You may refer to the guidance and examples provided that may assist you in making your judgment.

The following guidance provides information in making a judgment on whether an entity has significant influence over another entity [Paragraphs 14.3 (a, b, and c) of Section 14 – *Investments in Associates* of IFRS for SMEs]. You may refer to this guidance while making your judgment on the scenario.

- If an investor holds, directly or indirectly (eg through subsidiaries), 20 per cent or more of the voting power of the associate, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case.
- Conversely, if the investor holds, directly or indirectly (eg through subsidiaries), less than 20 per cent of the voting power of the associate, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated.
- A substantial or majority ownership by another investor does not preclude an investor from having significant influence.

You may further refer to the following additional guidance provided in Paragraphs 6 to 9 of IAS 28 – *Investments in Associates and Joint Ventures* of IFRS while making your judgment on the scenario.

- The existence of significant influence by an entity is usually evidenced in one or more of the following ways:
  - a) representation on the board of directors or equivalent governing body of the investee;
  - b) participation in policy-making processes, including participation in decisions about dividends or other distributions;
  - c) material transactions between the entity and its investee;
  - d) interchange of managerial personnel; or
  - e) provision of essential technical information.
- An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the entity additional voting power or to reduce another party's voting power over the financial and operating policies of another entity (i.e. potential voting rights). The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other entities, are considered when assessing whether an entity has significant influence. Potential voting rights are not currently exercisable or convertible when, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event.
- In assessing whether potential voting rights contribute to significant influence, the entity examines all facts and circumstances (including the terms of exercise of the potential voting rights and any other contractual arrangements whether considered individually or in combination) that affect potential rights, except the intentions of management and the financial ability to exercise or convert those potential rights.
- An entity loses significant influence over an investee when it loses the power to participate in the financial and operating policy decisions of that investee. The loss of significant influence can occur with or without a change in absolute or relative ownership levels. It could occur, for example, when an associate becomes subject to the control of a government, court, administrator or regulator. It could also occur as a result of a contractual arrangement.

Case – Investments in Associates

A medium-sized non-listed company, Max Ltd, is a wholesaler of automotive spare parts to a range of independent retailers and is the sole distributor for three major brands in the market (GT GAS, Ultima and Supercharge). Max Ltd holds 15% share of the country's automotive spare part market. In line with its new market strategy to diversify its operations, in July 2012, Max Ltd acquired full stake in Acme Ltd, a retail chain of hardware stores. Max Ltd prepares the financial statements in accordance with IFRS for SMEs, and the company's financial year ends on 30th June.

- During January 2013, Acme Ltd acquired 10% interest in the common stock of Logo Ltd, a retail chain in the automotive spare part market, operating in most provinces. In July 2013, Max Ltd acquired 8% interest in the common stock of Logo Ltd, with the intention of utilising proceeds from dividends to meet the expenses of the '7 Year Debentures' issued in April 2013 for its expansion project.
- As at 30 June 2014, the majority shareholder of Logo Ltd held 62% of common stock, while the second largest shareholder held 20% of common stocks. The remainder was held by Acme Ltd and Max Ltd.
- The Board of Directors of Logo Ltd consists of ten members. The majority shareholder was represented by six of the Board members, while the second largest shareholder was represented by two members. Max Ltd and Acme Ltd were represented by one member each. The Board makes decisions on the basis of a simple majority. The two Board members representing Max Ltd and Acme Ltd are fully engaged in their own business operations. The Board meetings of Logo Ltd are often held at very short notice. As such, Max Ltd and Acme Ltd Board representation is not available for most of the Board meetings of Logo Ltd.
- During the financial year ending 30 June 2014, Logo Ltd has purchased $4 million worth of spare parts on arms-length basis from its supplier base, out of which 25% was from Max Ltd. Logo Ltd's total turnover for the period is $9.35 million, recording a significant growth from last year's turnover of $4.3 million. 30% of this growth has been achieved from 'GT GAS' and 'Supercharge' brands.
- Max Ltd offers a strong marketing support and a wide range of retail services to its independent retailer network, including Logo Ltd by providing advisory and coaching on the marketing strategy to ensure greater customer satisfaction.

The accountant X who works for Max Ltd is of the view that "Max Ltd can account for its investment in Logo Ltd as an associate, because Max Ltd has the ability to exert significant influence over Logo Ltd".

The following two examples are also provided as guidance in making your judgment.

Example 01

It is likely that significant influence exists and there is an associate relationship for the following example.

Entity A was one of the three shareholder's in a regional airport, Entity B.

- As at 30 June 2014, the majority shareholder held 62% of voting shares, the second shareholder held 20% of voting shares and Entity A held 18% of the voting shares in Entity B.
- Entity B's Board of Directors consisted of ten members. The majority shareholder was represented by six of the Board members, while Entity A and the other shareholder were represented by two members each. A shareholders' agreement stated that certain Board and shareholder resolutions required either unanimous or majority decision. There is no indication that the majority shareholder and the other shareholders act together in a common way.
- During the financial year ending June 2014, Entity A had provided Entity B with maintenance and technical services and had sold Entity B a software licence for $4 million.
- Additionally, Entity A had sent a team of management experts to give business advice to the Board of Entity B.

Entity A appears to have significant influence over Entity B, and therefore, it should be accounted for as an associate.

Example 02

It is likely that significant influence does not exist and there is no associate relationship for the following example.

Entity X was one of the three shareholders in a garment manufacturing firm, Entity Y.

- As at 30 June 2014, the majority shareholder held 62% of voting shares and the second shareholder held 20% of voting shares in Entity Y. Entity X held 18% of the voting shares in Entity Y.
- Entity Y's Board of Directors consisted of ten members. The majority shareholder was represented by seven of the Board members, while the second largest shareholder was represented by two members. Entity X was represented by one Board member. The Board member of Entity X is always too busy to attend Board meetings. The Board makes decisions on the basis of a simple majority.
- During the financial year ended June 2014, Entity X has made a one-off sale of $4 million worth of computer aided fully integrated designing and manufacturing Machines to Entity Y. With this new technology Entity Y's overall production efficiency increased by almost 30%.
- Entity X had also sent a team of technical experts to give technical support for operating the new machines sold to Entity Y.

Entity X does not appear to have significant influence over Entity Y, and therefore, it should not be accounted for as an associate.

By applying IFRS for SMEs together with the guidance and the examples provided, record your judgment on Accountant X's view that Logo Ltd can be treated as an associate of Max Ltd.

Case	Strongly Disagree						Strongly Agree
Judgment	1	2	3	4	5	6	7

Please indicate the level of help the guidance provided in making your judgment on the following scale:						
Not at all Helpful			Of Some Help			Extremely Helpful
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐
Please indicate the level of help the examples provided in making your judgment on the following scale:						
Not at all Helpful			Of Some Help			Extremely Helpful
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐
Please indicate the extent to which the guidance provided enabled you to make a better judgment on the following scale:						
Not at All			To Some Extent			To a Great Extent
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐
Please indicate the extent to which the examples provided enabled you to make a better judgment on the following scale:						
Not at All			To Some Extent			To a Great Extent
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐
Please indicate how motivated you were to perform well on this case on the following scale:						
Not at All			Moderately Motivated			Extremely Motivated
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐
Please indicate how much effort you have expended on this case on the following scale:						
Very Little Effort			Moderate Effort			A Great Deal of Effort
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐
Please indicate the level of complexity of this case on the following scale:						
Not Complex			Moderately Complex			Extremely Complex
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐
Please indicate your level of familiarity in dealing with similar cases like this on the following scale:						
Not Familiar			Moderately Familiar			Very Familiar
1	2	3	4	5	6	7
☐	☐	☐	☐	☐	☐	☐

Thank you for taking the time to complete this instrument. Your assistance is very much appreciated. If you have any further comments, please provide them in the space provided.

Please make sure that you have <u>answered every question</u>. Missing questions will mean that all of your responses cannot be used.

Dinuja Perera
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Thank you very much for your participation!

APPENDIX 4

Research Instrument – Paper 4

(Questionnaire)

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Participant Information Form

Decision Usefulness of IFRS for SMEs

Supervisors: Associate Professor Parmod Chand and Dr Rajni Mala

You are invited to participate in a study which investigates the decision usefulness of International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs). This study aims to examine the users' perception towards the decision usefulness of the SME financial statements prepared in compliance with IFRS for SMEs.

The study is being conducted by Dinuja Perera [Department of Accounting and Corporate Governance, Macquarie University, NSW, Australia, dinuja.perera@mq.edu.au, Ph: (61) 414 729 623] to meet the requirements of Doctor of Philosophy under the supervision of Associate Professor Parmod Chand [parmod.chand@mq.edu.au, Ph: (612) 9850 6137] and Dr Rajni Mala [rajni.mala@mq.edu.au, Ph: (612) 9850 8530] of the Department of Accounting and Corporate Governance, Macquarie University.

If you decide to participate, you will be asked to complete a questionnaire. The questionnaire has two parts. Part one collects demographic data about the respondents. Part two consists of accounting information extracted from the IFRS for SMEs and you are asked to provide your opinion on the usefulness of each of the information when making a loan decision. It will take approximately 20-25 minutes to complete the questionnaire.

As you participate in this study as an individual, you are not considered to be a representative of your work organization or institution. The information provided by you represents your personal views only and not the views of your workplace. No sensitive personal information will be collected. Any information or personal details gathered in this study are confidential, except as required by law. No individual will be identified in any publication of the results. Data will be analysed in aggregate form, held and accessed solely by the researchers (Associate Professor Parmod Chand, Dr Rajni Mala and Dinuja Perera) and will not be used for any other purpose. The results of this study will be incorporated into Dinuja Perera's PhD thesis, which will be available at the Macquarie University Library for public access. A summary of the research results data can be made available to you on request by email to the researchers.

Participation in this survey is entirely voluntary. If you could complete the attached questionnaire, your time and co-operation will be greatly appreciated. If you do not wish to participate, simply do not return the questionnaire. Please note that completion and return of the questionnaire will be regarded as consent to use the information for research purposes.[1] To gain further insights, follow-up interviews will be carried out. Please indicate your willingness to participate in the follow-up interviews at the end of this questionnaire.

Please answer all questions. Your response is very important for the research which will contribute to understanding the perceptions of users on the decision usefulness of IFRS for SMEs.

[1] The ethical aspects of this study have been approved by the Macquarie University Human Research Ethics Committee. If you have any complaints or reservations about any ethical aspect of your participation in this research, you may contact the Committee through the Director, Research Ethics (telephone [02] 9850 7854, email: ethics@mq.edu.au). Any complaint you make will be treated in confidence and investigated, and you will be informed of the outcome. The local contact person is Mr Chaminda Ruwan Thilakerathne (telephone [+94] 112 903 654, email: chamindat@kln.ac.lk).

Section 1

YOUR PERSONAL PROFILE

Please respond to the following questions so that a profile for respondents can be developed.

1.	**Are you:** Male ☐ Female ☐
2.	**How old are you?** ☐ Under 20 years ☐ 20-24 ☐ 25-29 ☐ 30-34 ☐ 35-39 ☐ 40-49 ☐ 50-59 ☐ 60 or over
3.	**In total, how many years of formal education (primary, secondary and tertiary) did you complete?** ☐ Less than 15 years ☐ 15 years ☐ 16 years ☐ 17 years ☐ 18 years or over
4.	**Are you a member of:** the Institute of Bankers of Sri Lanka (IBSL)? ☐ ______________________ (Please state membership status) ______________ Other (please specify)
5.	**If you are a member of the IBSL, what level of qualification you have attained?** ☐ Certificate in Banking & Finance (CBF) ☐ Diploma in Banking & Finance (DBF)
6.	**Do you possess any professional accounting qualifications? Please specify** ______________________
7.	**In which type of organization do you work?** ☐ Commercial Bank ☐ Industrial Development Bank ______________ Other (please specify)
8.	**How large (in terms of qualified bankers) is the organization in which you work?** ☐ 1-5 ☐ 6-20 ☐ 21-100 ☐ Over 100
9.	**Which of the following best characterizes your main field of work?** ☐ Accepting Deposits ☐ Advancing Loans ☐ Credit Creations ☐ Trade Financing ______________ Other (please specify)
10.	**How many years of experience do you have in making lending decisions for Small and Medium-sized Enterprises (SMEs)?** _______ Years
11.	**Are you familiar with the Sri Lanka Financial Reporting Standards (SLFRS) for SMEs, equivalent of IFRS for SMEs?** ☐ Very Unfamiliar ☐ Unfamiliar ☐ Not Sure ☐ Familiar ☐ Very Familiar
12.	**Have you made any loan evaluations/approval decisions based on the financial statements prepared in compliance with SLFRS for SMEs?** ☐ None ☐ Limited ☐ Some ☐ Many

Section 2

Assume that you are a lending officer considering a term loan application received from a new client which is a medium-sized (non-listed) company. It prepares the financial statements in compliance with the Sri Lanka Financial Reporting Standards (SLFRS) for Small and Medium-sized Enterprises (SMEs), equivalent of IFRS for SMEs.

1. To what extent the following statements describe your analysis of the loan application for a medium-sized (non-listed) company?

	Strongly Disagree				Strongly Agree
i. My lending decision is based on first-hand information and impression of management quality	1	2	3	4	5
ii. My lending decision is based on accounting information of the company	1	2	3	4	5
iii. My lending decision is based on non-accounting information of the company	1	2	3	4	5
iv. My method of analysis differs according to the respective client/company	1	2	3	4	5

Please list any other factor(s) that describe your analysis of the loan application for a medium-sized (non-listed) company:

2. What sources of information do you use when making a term loan decision? Please assess the following sources in terms of the usefulness in making a term loan decision for a medium-sized (non-listed) company.

	Not Useful				Extremely Useful
i. General information about the client and business	1	2	3	4	5
ii. Annual Financial Statements:					
a) Income Statement	1	2	3	4	5
b) Balance Sheet	1	2	3	4	5
c) Cash Flow Statement	1	2	3	4	5
d) Statement of Changes in Equity and Income & Retained Earnings	1	2	3	4	5
e) Statement of Accounting Policies	1	2	3	4	5
f) Related Party Disclosures	1	2	3	4	5
g) Notes to the Annual Financial Statements	1	2	3	4	5
iii. Business Plan	1	2	3	4	5
iv. Business Credit Report	1	2	3	4	5
v. Income Tax Returns	1	2	3	4	5
vi. Bank Statements	1	2	3	4	5
vii. Collateral Documents	1	2	3	4	5
viii. List of Guarantees Proposed	1	2	3	4	5
ix. Legal Documents	1	2	3	4	5

Please list any other sources of information you consider useful when making a term loan decision for a medium-sized (non-listed) company:

3. Financial accounting uses different valuation concepts for measuring assets and liabilities.

Please indicate how familiar you are with the following measurement concepts.

	Measurement Concept	Very Unfamiliar				Very Familiar
i.	Historical cost	1	2	3	4	5
ii.	Lower of cost or Market value	1	2	3	4	5
iii.	Value in use	1	2	3	4	5
iv.	Fair value	1	2	3	4	5

4. Please give your opinion on the following statements. Your assessments should be based on the usefulness of the measurement concepts of assets/liabilities when making a term loan decision for a medium-sized (non-listed) company:

		Strongly Disagree				Strongly Agree
i.	All assets and liabilities should be reported following the same measurement concept	1	2	3	4	5
ii.	All assets and liabilities should be reported at fair value, with historical cost information presented in the notes	1	2	3	4	5
iii.	All assets and liabilities should be reported at historical cost, with fair value information presented in the notes	1	2	3	4	5
iv.	Assets and liabilities should be reported following different measurement concepts, with the relevant measurement concept depending on the nature of the asset or liability	1	2	3	4	5
v.	Companies should be permitted to choose among alternative measurement concepts for different classes of assets and/or liabilities	1	2	3	4	5

5. The SLFRS for SMEs requires the following presentations and disclosures to be included in financial statements and in the notes to the financial statements of an SME.

The following tables consist of a number of information items specified by the SLFRS for SMEs that you might need when making a typical term loan decision for a medium-sized (non-listed) company.

You are required to evaluate each information item independently and circle the response that best represents your opinion on the usefulness of each of the information when making a lending decision.

a) Please indicate the extent to which the following information disclosed in the Statement of Financial Position (Balance Sheet) are useful when making a term loan decision:

Information Item	Not Useful				Extremely Useful
i. Cash and cash equivalents	1	2	3	4	5
ii. Trade and other receivables	1	2	3	4	5
iii. Financial assets	1	2	3	4	5
iv. Inventories	1	2	3	4	5
v. Property, plant and equipment measured at historical cost	1	2	3	4	5
vi. Investment property carried at fair value through profit or loss	1	2	3	4	5
vii. Intangible assets	1	2	3	4	5
viii. Biological assets carried at cost less accumulated depreciation and impairment	1	2	3	4	5
ix. Biological assets carried at fair value through profit or loss	1	2	3	4	5
x. Investments in associates carried at fair value through profit or loss	1	2	3	4	5
xi. Investments in jointly controlled entities carried at fair value through profit or loss	1	2	3	4	5
xii. Trade and other payables	1	2	3	4	5
xiii. Financial liabilities (except trade & other payables and provisions)	1	2	3	4	5
xiv. Liabilities and assets for current tax	1	2	3	4	5
xv. Deferred tax liabilities and deferred tax assets	1	2	3	4	5
xvi. Provisions	1	2	3	4	5
xvii. Non-controlling interests, presented within equity separately from equity attributable to the owners of the parent	1	2	3	4	5
xviii. Equity attributable to the owners of the parent	1	2	3	4	5

b) Please indicate the extent to which the Sub-Classification of the following items disclosed in the Statement of Financial Position (Balance Sheet) or in the Notes are useful when making a term loan decision:

Information Item	Not Useful				Extremely Useful
i. Property, plant and equipment in classifications appropriate to the entity	1	2	3	4	5
ii. Trade and other receivables showing separately amounts due from related parties, amounts due from other parties, and receivables arising from accrued income not yet billed	1	2	3	4	5
iii. Inventories, showing separately amounts of inventories: a) held for sale in the ordinary course of business b) in the process of production for such sale c) in the form of materials or supplies to be consumed in the production process or in the rendering of services	1	2	3	4	5
iv. Trade and other payables, showing separately amounts payable to trade suppliers, payable to related parties, deferred income and accruals	1	2	3	4	5
v. Provisions for employee benefits and other provisions	1	2	3	4	5
vi. Classes of equity, such as paid-in capital, share premium, retained earnings and items of income and expense	1	2	3	4	5
vii. An entity with share capital, for each class of share capital: a) the number of shares authorised b) the number of shares issued and fully paid, and issued but not fully paid c) par value per share, or that the shares have no par value d) a reconciliation of the number of shares outstanding at the beginning and at the end of the period e) the rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital f) shares in the entity held by the entity or by its subsidiaries or associates g) shares reserved for issue under options and contracts for the sale of shares, including the terms and amounts	1	2	3	4	5

c) **Please indicate the extent to which the following information disclosed in the Statement of Comprehensive Income (Income Statement) are useful when making a term loan decision:**

Information Item	Not Useful				Extremely Useful
i. Revenue	1	2	3	4	5
ii. Finance costs	1	2	3	4	5
iii. Share of the profit or loss of investments in associates	1	2	3	4	5
iv. Share of the profit or loss of jointly controlled entities accounted for using the equity method	1	2	3	4	5
v. Tax expense	1	2	3	4	5
vi. A single amount comprising the total of: a) the post-tax profit or loss of a discontinued operation, and b) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the net assets constituting the discontinued operation	1	2	3	4	5
vii. Profit or loss	1	2	3	4	5
viii. Each item of other comprehensive income classified by nature	1	2	3	4	5
ix. Share of the other comprehensive income of associates and jointly controlled entities accounted for by the equity method	1	2	3	4	5
x. Total comprehensive income	1	2	3	4	5
xi. Profit or loss for the period attributable to: a) non-controlling interest b) owners of the parent	1	2	3	4	5
xii. Total comprehensive income for the period attributable to: a) non-controlling interest b) owners of the parent	1	2	3	4	5
xiii. An analysis of expenses using a classification based on the nature of expenses (e.g. depreciation, purchases of materials, transport costs, employee benefits and advertising costs) within the entity	1	2	3	4	5
xiv. An analysis of expenses using a classification based on the function of expenses (e.g. cost of sales, cost of distribution or administrative activities) within the entity	1	2	3	4	5

d) Please indicate the extent to which the following information disclosed in the Statement of Changes in Equity and Statement of Income & Retained Earnings are useful when making a term loan decision:

Information Item	Not Useful				Extremely Useful
i. Total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to non-controlling interests	1	2	3	4	5
ii. For each component of equity, the effects of retrospective application or retrospective restatement recognised	1	2	3	4	5
iii. For each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing changes resulting from: a) profit or loss b) each item of other comprehensive income c) the amounts of investments by, and dividends and other distributions to, owners, showing separately issues of shares, treasury share transactions, dividends and other distributions to owners, and changes in ownership interests in subsidiaries that do not result in a loss of control	1	2	3	4	5
iv. In the statement of income and retained earnings: a) retained earnings at the beginning of the reporting period b) dividends declared and paid or payable during the period c) restatements of retained earnings for corrections of prior period errors d) restatements of retained earnings for changes in accounting policy e) retained earnings at the end of the reporting period	1	2	3	4	5

e) **Please indicate the extent to which the following information disclosed in the Statement of Cash Flows are useful when making a term loan decision:**

Information Item	Not Useful				Extremely Useful
i. Cash flows for a reporting period classified by operating activities, investing activities and financing activities	1	2	3	4	5
ii. Cash flows from operating activities using:					
a) the indirect method, whereby profit or loss is adjusted for the effects of non-cash transactions, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows	1	2	3	4	5
b) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed	1	2	3	4	5
iii. Major classes of gross cash receipts and gross cash payments arising from investing activities	1	2	3	4	5
iv. Major classes of gross cash receipts and gross cash payments arising from financing activities	1	2	3	4	5
v. Cash flows arising from transactions in a foreign currency	1	2	3	4	5
vi. Cash flows from interest and dividends received and paid	1	2	3	4	5
vii. Cash flows arising from income tax	1	2	3	4	5
viii. The amount of significant cash and cash equivalent balances held by the entity that are not available for use by the entity (because of foreign exchange controls or legal restrictions, etc.)	1	2	3	4	5

f) **Please indicate the extent to which the following information disclosed in the Notes to the Financial Statements are useful when making a term loan decision:**

Information Item	Not Useful				Extremely Useful
i. A statement that the financial statements have been prepared in compliance with the SLFRS for SMEs	1	2	3	4	5
ii. A summary of significant accounting policies applied: a) the measurement basis (or bases) used in preparing the financial statements b) the other accounting policies used that are relevant to an understanding of the financial statements	1	2	3	4	5
iii. The judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements	1	2	3	4	5
iv. The key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year	1	2	3	4	5

Thank you for taking the time to complete this instrument. Your assistance is very much appreciated. If you have any further comments, please provide them in the space provided.

Please make sure that you have <u>answered every question</u>. Missing questions will mean that all of your responses cannot be used.

Are you willing to participate in a follow-up interview? Yes ☐ No ☐

If "Yes," please provide your

Name: ____________________

Contact Number: ____________________

Email: ____________________

Dinuja Perera
Department of Accounting and Corporate Governance
Faculty of Business and Economics
Macquarie University
NSW 2109
Australia

(Interview Guide)

Interview Guide

	Name:
	Date:
	Location:
	Time:
1.	**Interview Introduction**
	▪ Brief explanation of the interview process and response to interviewee's questions
	▪ Participants will be reminded that the interview is recorded (if they agree)
2.	**Role of accounting information (Financial Statements)**
	▪ How familiar are you with SLFRS for SMEs?
	▪ Have you made any loan evaluations/approval decisions based on the financial statements prepared in compliance with SLFRS for SMEs?
	▪ What is the usefulness of accounting information (financial statements) on your lending decisions?
	▪ What are the key quantitative/qualitative aspects that you use from the financial statements?
	▪ How much time do you spend in evaluating financial statements?
3.	**Perceptions and use of financial statements prepared in compliance with SLFRS for SMEs**
	▪ To what extent the accounting information contained in the financial statements (prepared in accordance with SLFRS for SMEs) helps you to make better lending decisions?
	▪ Do you find any "information overload" in financial statements prepared in compliance with SLFRS for SMEs (i.e. they are not useful for your lending decisions)?
	The International Accounting Standards Board (IASB) makes the following claim that: "An explicit and unreserved statement indicating that the company's financial statements have been prepared in compliance with the IFRS for SMEs would enhance the reliability of the financial information provided by the entity." ▪ To what extent this statement enhances the reliability of your lending decisions based on SLFRS for SMEs?
	▪ Do you think that the reliability of financial statements prepared in compliance with SLFRS for SMEs is enhanced when they are audited?
	▪ Do you believe that complete financial reports prepared in compliance with SLFRS for SMEs helps to lower the borrower's cost of capital?

▪ Are you satisfied with the General Purpose Financial Statements (GPFSs) prepared in compliance with SLFRS for SMEs? OR ▪ Do you require SME borrowers to prepare project/loan based Special Purpose Reports (SPR) which satisfy specific accounting requirements of the bank?
▪ Is there an intensive competition among the commercial banks for attracting SME customers? ▪ If yes, do you believe that requesting those SPR lead to a potential loss of customers?
4. Perceptions of the simplified measurement and recognition requirements of SLFRSs for SMEs
"The SLFRS for SMEs mandates some recognition or measurement requirements that are different from measurement under full IFRS. For example, the standard does not allow the revaluation policy option on property, plant and equipment for SMEs. The assets will only be measured at their historical cost." ▪ Does this prohibition of revaluation impact your credit decision?
"The SLFRS for SMEs requires all research and development costs to be recognised as expenses when incurred. However, IAS 38 of full IFRS requires all research costs to be charged to expense when incurred, but development costs incurred after the project is deemed to be commercially viable are to be capitalised." ▪ Do you think that this different treatment on development cost has an impact on your credit decisions?
▪ To what extent the fair values for certain assets classes are useful for your lending decisions (such as investments in associates, investments in jointly controlled entities for which there are published price quotations)?
▪ To what extent the deferred tax accounting disclosures are useful in your lending decisions?
"The topics relevant to Earnings Per Share, Interim Financial Reporting, Segment Reporting and Special Accounting for Assets held for Sale are not addressed by the SLFRS for SMEs." ▪ Do you consider that the absence of these information have an impact on your lending decisions?
5. Conclusion of Interview
▪ Do you have any other concerns/comments other than what we have discussed on SLFRS for SMEs? Please indicate.

APPENDIX 5

Participant Information and Consent Form – Paper 4

Investigator's Copy

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Faculty of Business and Economics
Macquarie University NSW 2109
Phone: +61 2 9850 6137
Fax: +61 2 9850 8497
Email: parmod.chand@mq.edu.au

Participant Information and Consent Form

Decision Usefulness of IFRS for SMEs

Supervisors: Associate Professor Parmod Chand and Dr Rajni Mala

You are invited to participate in a study which investigates the decision usefulness of International Financial Reporting Standards (IFRS) for Small and Medium-Sized Enterprises (SMEs). This study aims to examine the users' perception towards the decision usefulness of the SME financial statements prepared in compliance with IFRS for SMEs.

The study is being conducted by Dinuja Perera [Department of Accounting and Corporate Governance, Macquarie University, NSW, Australia, dinuja.perera@mq.edu.au, Ph: (61) 414 729 623] to meet the requirements of Doctor of Philosophy under the supervision of Associate Professor Parmod Chand [parmod.chand@mq.edu.au, Ph: (612) 9850 6137] and Dr Rajni Mala [rajni.mala@mq.edu.au, Ph: (612) 9850 8530] of the Department of Accounting and Corporate Governance, Macquarie University.

You are invited to participate in an interview that will take approximately 30-45 minutes of your time. Questions will include your perception on the usefulness of financial statements prepared in compliance with IFRS for SMEs on your lending decisions for SMEs. If you agree, then your interview will be audio-recorded. The audio recording or any notes taken during the interview will be transcribed by the investigator (Dinuja Perera) and you will have the ability to verify your comments and responses prior to the final inclusion in the research project. Your identity will be kept confidential. For the purpose of analysis, the research project will only use anonymous codes for each interview participant.

As you participate in this study as an individual, you are not considered to be a representative of your work organization or institution. The information provided by you represents your personal views only and not the views of your workplace. No sensitive personal information will be collected. Any information or personal details gathered in this study are confidential, except as required by law. No individual will be identified in any publication of the results. Data will be held and accessed solely by the researchers (Associate Professor Parmod Chand, Dr Rajni Mala and Dinuja Perera) and will not be used for any other purpose. The results of this study will be incorporated into Dinuja Perera's PhD thesis, which will be available at the Macquarie University Library for public access. A summary of the research results data can be made available to you on request by email to the researchers.

Participation in this interview is entirely voluntary. You are not obliged to participate and if you decide to participate, you are free to withdraw at any time without having to give reasons and without consequences. If you could participate, your time and co-operation will be greatly appreciated. You are requested to sign the written Participant Information and Consent Form enclosed to confirm your agreement to participate. You will be given a copy of the consent form to keep as a record.[1]

[1] The ethical aspects of this study have been approved by the Macquarie University Human Research Ethics Committee. If you have any complaints or reservations about any ethical aspect of your participation in this research, you may contact the Committee through the Director, Research Ethics (telephone [02] 9850 7854, email: ethics@mq.edu.au). Any complaint you make will be treated in confidence and investigated, and you will be informed of the outcome. The local contact person is Mr Chaminda Ruwan Thilakerathne (telephone [+94] 112 903 654, email: chamindat@kln.ac.lk)

I agree to participate in this research.

Participant's Name:____

(Block letters)

Participant's Signature: ____________________________Date:______________________

Investigator's Name:____

(Block letters)

Investigator's Signature: ________________ Date: _______________

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Participant Information and Consent Form

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Supervisors: Associate Professor Parmod Chand and Dr Rajni Mala

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The study is being conducted by Dinuja Perera [Department of Accounting and Corporate Governance, Macquarie University, NSW, Australia, dinuja.perera@mq.edu.au, Ph: (61) 414 729 623] to meet the requirements of Doctor of Philosophy under the supervision of Associate Professor Parmod Chand [parmod.chand@mq.edu.au, Ph: (612) 9850 6137] and Dr Rajni Mala [rajni.mala@mq.edu.au, Ph: (612) 9850 8530] of the Department of Accounting and Corporate Governance, Macquarie University.

You are invited to participate in an interview that will take approximately 30-45 minutes of your time. Questions will include your perception on the usefulness of financial statements prepared in compliance with IFRS for SMEs on your lending decisions for SMEs. If you agree, then your interview will be audio-recorded. The audio recording or any notes taken during the interview will be transcribed by the investigator (Dinuja Perera) and you will have the ability to verify your comments and responses prior to the final inclusion in the research project. Your identity will be kept confidential. For the purpose of analysis, the research project will only use anonymous codes for each interview participant.

As you participate in this study as an individual, you are not considered to be a representative of your work organization or institution. The information provided by you represents your personal views only and not the views of your workplace. No sensitive personal information will be collected. Any information or personal details gathered in this study are confidential, except as required by law. No individual will be identified in any publication of the results. Data will be held and accessed solely by the researchers (Associate Professor Parmod Chand, Dr Rajni Mala and Dinuja Perera) and will not be used for any other purpose. The results of this study will be incorporated into Dinuja Perera's PhD thesis, which will be available at the Macquarie University Library for public access. A summary of the research results data can be made available to you on request by email to the researchers.

Participation in this interview is entirely voluntary. You are not obliged to participate and if you decide to participate, you are free to withdraw at any time without having to give reasons and without consequences. If you could participate, your time and co-operation will be greatly appreciated. You are requested to sign the written Participant Information and Consent Form enclosed to confirm your agreement to participate. You will be given a copy of the consent form to keep as a record.[1]

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I agree to participate in this research.

Participant's Name:____

(Block letters)

Participant's Signature: ____________________________Date:______________________

Investigator's Name:____

(Block letters)

Investigator's Signature: _________________ Date: ________________

APPENDIX 6

Thematic Node Hierarchy – Paper 4

Thematic node hierarchy

1. Simplified IFRS for SMEs
    - 1.1 Recognition & measurement requirements
        - 1.1.1 Revaluation of PPE
            - 1.1.1.1 Dilution of risk
            - 1.1.1.2 Assets valuation
            - 1.1.1.3 Re-payment ability
            - 1.1.1.4 Annual review
        - 1.1.2 Capitalisation of development cost
            - 1.1.2.1 Aggregated analysis
            - 1.1.2.2 New ventures
            - 1.1.2.3 Re-payment capacity
        - 1.1.3. Accounting for deferred tax
            - 1.1.3.1 Disclosure
            - 1.1.3.2 Business nature & size
            - 1.1.3.3 Taxes payable method
        - 1.1.4 Fair value (FV) measurements
            - 1.1.4.1 Asset classes
            - 1.1.4.2 Mark-to-market FV
            - 1.1.4.3 Financial instruments
            - 1.1.4.4 Business nature & size
    - 1.2 Topics omitted from IFRS for SMEs
        - 1.2.1 Earnings per share
        - 1.2.2 Segment reporting
        - 1.2.3 Interim reporting
            - 1.2.3.1 Management accounts
            - 1.2.3.2 Audited accounts
2. Role of accounting information
    - 2.1 Accuracy
    - 2.2 Comparability
    - 2.3 Process
    - 2.4 Benchmarking
    - 2.5 Uniformity
    - 2.6 Credit score
    - 2.7 Five Cs
    - 2.8 Financial capacity
    - 2.9 Accounting quality
    - 2.10 Forecasts
    - 2.11 Intensive competition
3. Compliance with IFRS for SMEs
    - 3.1 Pricing decisions
    - 3.2 Relationship lending
    - 3.3 Customer bargaining power
    - 3.4 Audited reports
    - 3.5 Auditor’s reputation
    - 3.6 Confidence
    - 3.7 Reliability