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Challenges of Meeting International Financial Reporting Standards for SMEs in Georgia

Sophio Khundadze*
Gvantsa Amiridze**

Abstract

The paper focuses on the challenges faced by small and medium-sized entities (SMEs) in Georgia through adopting International Financial Reporting Standards (IFRS) for SMEs. It describes a new law issued in 2015 by the Parliament of Georgia, according to which entities should use translated versions of IFRS, IFRS for SMEs, International Standards for Auditing (ISA) and the last publication of International Ethics Standards Board for Accountants (IESBA) Code from January 1, 2017. International experiences of implementing IFRS for SMEs of several developing countries, which have already overcome the problems of implementation was obsrved. In addition, the paper presents research findings of the study conducted in order to identify problems faced by small and medium-sized entities in Georgia through adopting IFRS for SMEs. The paper offers the ways of resolving these problems by considering international practisesand the analysis of research results and findings. The article highlights the role of the government in this process.

Keywords: financial reporting, financial statements, Georgia, International Financial Reporting Standards (IFRS), small and medium-sized entities (SMEs)

JEL: M40, M41, M48

Introduction

The law on “Accounting and Financial Audit” issued in 2015 defined that from January 1, 2017 in purpose of an accounting and financial audit in Georgia, entities should use translated version of International Financial Reporting Standards (IFRS), IFRS for small and medium-sized entities (SMEs), International Standards for Auditing (ISA) and the last publication of International Ethics Standards Board for Accountants (IESBA) Code.

Implementation of IFRS standards for SMEs has a number of advantages: the presence of a complete set of accounting principles, simplified for each type of entity; increased satisfaction of the financial statements users by meeting their needs; reduced costs associated with maintaining accounting standards; providing a platform for enterprises, which are preparing to enter the capital markets. Some claim that implementation of standards should increase the transparency of entities’ financial statements. Entities can gain business partners easier and obtain additional financial resources. On the other hand, entities will face costs of adoption. Basic costs include staff training, IT support, undue cost burden of reporting, which is proportionately heavier for smaller firms.

Therefore, the issues of implementation of IFRS standards for SMEs and its effect over the entities became very critical issue for Georgia.

The aim of the paper is to evaluate current approach to the adoption of IFRS for SMEs and its implementation in Georgia, as well as to analyze the problems connected with the harmonization of financial reporting legislation used by SMEs. The purpose of the research is to define the effect of IFRS for SMEs on the small and medium-sized entities in Georgia.

Research focuses on the following research questions:

1. What are the challenges and problems faced by SMEs in Georgia by adopting IFRS?
2. What are the international practices of overcoming these difficulties of adopting IFRS?
3. What kind of support SMEs need to overcome the difficulties faced by them through the adoption of IFRS for SMEs?

*Assoc. Prof. Dr., Faculty of Business Management, International Black Sea University, Tbilisi, Georgia. E-mail: skhundadze@ibsu.edu.ge

**Master of Business Administration, Faculty of Business Management, International Black Sea University, Tbilisi, Georgia. E-mail: gvantsaamiridze@gmail.com

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Concepts of IFRS, IFRS for SMEs, Advantages and Challenges of IFRS Adoption

International Financial Reporting Standards are the set of international accounting standards, which provide instructions about reporting particular types of transactions and other events in the financial statements. International Accounting Standards Board (IASB) issues IFRS, and they specify how accountants must maintain and report their accounts. IFRS were established, in order to have a common accounting language, so business and accounts can be understood from company to company and country to country (American Institute of CPA, 2017).

Moving to IFRS standard has plenty of advantages. However, it has some challenges as well.

The International Federation of Accountants Commission (IFAC) undertook a study on the challenges and successes in the implementation of IAS. The commission's report, which was issued in September 2004, categorized seven challenges that were likely to arise from the adoption of international accounting standards and indicated that the issues of legitimacy and authority of IASB are subsumed in all the seven challenges (Wong, 2004). Among the challenges was the issue of incentives that might encourage or discourage national decision makers from adoption. Country sovereignty has also been an issue, as individual countries try to debate whether the adoption of the standards would be an infringement on their sovereignty. Australia and the European Union are typical examples among others, where sovereignty has been an important consideration in the adoption approaches. The EU also quickly adopted IFRS, as a political strategy, in what was meant to prove EU's independence from U.S. influence. In South Africa, concerns about state sovereignty have been addressed through the alignment of IFRS, with national standards, as opposed to its full adoption by the state. The second factor in these challenges was the question of regulation. Many countries around the world have laws that prescribe how companies are formed and managed and the nature of reports that should be issued. The way IFRS has been issued by IASB, from London is that local legislation of different countries has not been taken into account. A key controversy in this area is that IASB uses the terms "true" and "fair" view, which appear in country statutes, but a true and fair view has not been properly defined. Cultural factors have also featured prominently in the adoption of IFRS. Islamic culture has been of particular interest, where interest cannot be charged in lending, which would automatically create problems in revenue recognition. IFRS implementation in Malaysia has cited this as a problem, while a study in Egypt confirmed the same because of the secretive nature of related party transactions in Egypt. This made it impossible to fully implement related party disclosures (IFRS 8) as such disclosures are a taboo. The fifth challenge that has been cited is understandability, which is one of the four qualitative characteristics of accounting information. It has also been one of the critiques of financial statements that some people do not understand financial statements. The translation of standards to different languages is problematic because information may be lost in the process of translation. The question of education, given that IFRS is a new area and is constantly evolving, also needs to be addressed. University syllabuses and other educational institutions need to adopt IFRS as part of their training. The other challenges have been questions of cost and benefits. For small- to medium-size enterprises a single set of standards has been proposed; but for the big companies the cost of conversion has been huge. Nevertheless, these concerns may be superseded by views that the long-term benefits of IFRS adoption outweigh the short-term transition costs of its implementation (Outa, 2013).

The costs are dependent on the size and nature of the business. Basic costs include staff training and IT support (Freedman, 2017). However, American Institute of CPA (2017) claims that in the countries that have adopted IFRS, both companies and investors benefit from using the system, since investors are more likely to put money into a company if the company's business practices are transparent. Companies that do a lot of international business, benefit the most from the adoption of IFRS. By adopting IFRS, a business can present its financial statements on the same basis as its foreign competitors, making comparisons easier. Furthermore, companies with subsidiaries in countries that require or permit IFRS may be able to use one accounting language company-wide. Companies also may need to convert to IFRS if they are a subsidiary of a foreign company that must use IFRS, or if they have a foreign investor that must use IFRS. Companies may also benefit by using IFRS if they wish to raise capital abroad (American Institute of CPA, 2017).

The requirements and constraints of financial reporting carried out by SMEs are different from those applied to large companies. Information requirements should be assessed in terms of the cost-benefit. Therefore, in order to help SMEs, IASB issued in July 2009 IFRS for SMEs, a simplified version of IFRS for those entities, for which complete IFRS application would have been too complex. The reasons for which the IASB has proposed a standard for SMEs have been generated by the need for comparing the financial information and the need for high quality information. According to the IASB, IFRS objectives for SME's are:

1. To provide standards for quality, which focus on the needs of SMEs, do not depart from the IASB accounting framework and is easy to understand for all SMEs;
2. To reduce financial reporting requirements for SMEs, which want to apply IFRS. To facilitate transition to the full IFRS, for SMEs listed on the stock exchange, or which choose to use these instructions (Sorin, 2013).

In order to reduce the burden of reporting, IFRS for SMEs contain five types of simplifications compared to complete IFRS:

1. Some aspects of IFRS are omitted because they are not relevant to SMEs;
2. If IFRS sites present policy options in accounting, this standard is only an option or a simplified method;
3. Simplification of the recognition and evaluation principles, which are presented in the complete IFRS;

4. Presentations of information are substantially reduced;
5. Simplified development of standard (Mourik & Walton, 2014).

Scholars started to argue about benefit and costs of adopting IFRS for SMEs long ago. Sorin (2013) names following advantages of implementation of IFRS standards for SMEs: the presence of a complete set of accounting principles, simplified for each type of entity. It increases the satisfaction of the users of financial statements by meeting their needs. According to him, other advantages are reduced costs associated with maintaining accounting standards and providing a platform for enterprises, which are preparing to enter in the capital markets (Sorin, 2013).

Stokdyk (2010) highlighted the advantages for comparing financial statements prepared in different jurisdictions, which would encourage more cross-border trade and merger/acquisition activities and lower the cost of raising finances. For companies, that operated subsidiaries in different EU member states, the SME standards would make preparing consolidated accounts easier as there would be no need for reconciling national accounting treatments. Audit costs would be lower too. The development of a common educational framework for accountants around the standard could pave the way for more mobility of accountants and audit services within the EU. Opponents to the application of IFRS for SMEs in Europe stressed the standard's complexity, particularly for small companies. For companies operating in just one country, that have no need for cross-border comparability, the extra burden the standard imposed would outweigh any potential benefits. The IFRS for SMEs is not suitable for internal management, they argue that it would increase the cost of preparation and audit of individual company accounts and the increased disclosure requirements could potentially put companies, that adopted it at a competitive disadvantage to firms using less stringent accounting rules (Stokdyk, 2010).

International Practices of Adopting IFRS for SMEs

Czech Republic: The Czech Republic has already adopted IFRS Standards for the consolidated financial statements of all companies whose securities are traded in a regulated market. As a member state of the European Union, the Czech Republic is subject to the IAS Regulation adopted by the European Union in 2002. The EU IAS Regulation requires application of IFRS Standards as adopted by the EU for the consolidated financial statements of European companies whose securities trade in a regulated securities market starting in 2005. The EU IAS Regulation gives member states the option to require or permit IFRS Standards as adopted by the EU in separate company financial statements (statutory accounts) and/or in the financial statements of companies whose securities do not trade on a regulated securities market.

The survey conducted in the Czech Republic after the adoption of IFRS for SMEs aimed at the identification of the problems of reporting, i.e. whether the company also prepares its financial statements based on any, than national accounting system. 115 small and medium-sized enterprises took part in the survey. According to the survey, just three Czech companies report under other than local accounting framework. Out of these, three Czech companies report according to IFRS, and one Czech company according to the French GAAP. The Czech companies reporting under IFRS framework find the biggest problem in reporting of long-term assets, provisions, exchange rates differences and financial leases. It is given by the impossibility of measurement at present values in the Czech Republic. To find out, how the companies evaluate the various areas of accounting and difficulty of transition to reporting by IFRS, they were asked to select the areas of their accounting that appear to them as important and also select those considered to be difficult. They have possibility to select areas from the following reporting items: inventories, receivables, accruals, long-term assets, financial assets, equity, liabilities, expenses and cost. Rates of representation of items considered important in Czech Republic. The Czech companies consider the inventory, financial assets and receivables items important, among the problematic items (Pasekova, Mullerova, Strouhal, & Chyzhevsk, 2010). There are discussed results of the research done by Jiří Strouhal, in 2012, on the base of structural interviews with the representatives of accounting profession (preparer, auditor, user, professional chamber and accounting regulator). Interviewees believe that the major costs of a possible application of the IFRS for SMEs will be additional costs connected to the preparation of second financial statements based on Czech accounting regulation due to the tax purposes. Interviewees are convinced that the major benefit of the adoption of the IFRS for SMEs would be the unification of accounting methods and principles, which will lead towards higher comparability of accounting information. Possible application of the IFRS for SMEs might be considered as an opportunity to change the strong linkage of accounting and tax system in the Czech Republic (Strouhal, 2012).

Ukraine: IFRS Standards became mandatory for all companies whose securities trade in a public market from January 1, 2012. Optionally, IFRS Standards were permitted from January 1, 2011. However, commercial banks were required to apply IFRS Standards in their annual financial statements from January 1, 2011.

To find out challenges faced by small and medium-sized entities in Ukraine by adoption of IFRS for SMEs, the survey was conducted in Ukraine as well.50 small and medium-sized enterprises took part in the study. The Ukrainian companies claim, that their accounting practice is focused mainly to areas of liabilities, inventories, expenses, receivables and revenues. The receivables, inventories and expenses are the most often selected problematic items. The problematic items also include long-term and financial assets and accruals but with less incidence ratio. Ukrainian companies emerge expenses, receivables, revenues, payables and inventories. Still, majority of companies use accounting just to provide data, which are necessary for calculation of the tax base; accounting information for the managerial purposes are rarely used by SMEs. They state that application of IFRS is for them an inadequate administrative burden compared to the revenues obtained. The imperfection of available database on SMEs businesses does not allow accomplishing the complete analysis of development and significance of the small entrepreneurship in the forming of macroeconomic indices in Ukraine. It can be explained by the fact that there are no unified criteria for small business entity for the purpose of statistics and financial accounting. Taking into consideration the changes in IFRS and lack of the unanimous opinion of EU member countries, concerning the perspectives of applying IFRS for SMEs, they believe it is necessary to form the national conception of simplifying the accounting system and financial reporting (Pasekova, Mullerova, Strouhal, & Chyzhevsk, 2010). As of today, only very few SMEs use internationally accepted accounting standards such as IFRS in Ukraine, As a result, it is difficult for banks – especially Western-owned banks – to make a solid judgment about the creditworthiness of a potential borrower. The same problem applies for another form of finance: equity. If a Western investor intends to acquire equity in a small or a medium-sized business, he will face the problem of not having reliable accounting books. For this reason, fresh capital, which would have financed new investments, does not flow (BE Berlin Economics GmbH, 2014).

Moldova: Moldova made a commitment to IFRS Standards in Government Decision No. 238 dated 29 February 2008. That Decision requires the use of IFRS Standards by all public interest entities in the Republic of Moldova since January 1, 2012. 98% of companies from the Republic of Moldova are small and medium sized entities, for which, reporting according to IFRS provisions is difficult and expensive.

Budgetary funds were insufficient to reform the financial reporting regulatory framework, covering only a small part of the expenses related to improving the financial reporting regulatory framework and strengthening the key institutions responsible for financial reporting (Ghedrovici , Mihailaa, Erhan, & Birca , 2014). Reporting regulatory framework was an important step in harmonizing economic relations between the Republic of Moldova and other countries, in attracting the foreign investments, in capital market development and for improving local business competitiveness on the international market.

In the Republic of Moldova, the process of adaptation and reforming the financial regulatory framework was a difficult and lengthy one. There existed and still persist problems of vocabulary, practical applicability because of the insufficient number of trained specialists, perception, and assimilation regarding the essence of the new standards. Nevertheless, the advantages of implementing international standards are much higher, compared with the transition costs, because reporting according to the international standards will contribute to a substantial reduction in the cost of systematization, processing and presentation of information. As a result, there will be established a common language of financial reporting and will be harmonized the economic relations between states. This will increase the transparency, comparability of information between companies in the same field of activity, but on different markets, will increase the number of foreign investors and their confidence in national financial reporting quality. As a benefit of international standards implementation, may be that, on medium and long term, it ensures an increase in liquidity of all entities applying IFRS for SMEs and, as a result, it reduces the risks related to every entity. Most entities have adopted IFRS for SMEs, because it prepared consolidated financial statements, the process being a very expensive and complex one, causing problems, problems that are substantially reduced by the use of IFRS. Intensification of the globalization process is the main premise for the implementation of IFRS, and at the same time, the global adoption of uniform standards tends to reduce costs, increase efficiency and significantly increase investments in capital markets, both on national and international level. The companies hope to increase their financial results through the implementation of IFRS for SMEs.

Kazakhstan: Reforming the system of accounting and financial reporting in the Republic of Kazakhstan continues for more than twenty years. The initial stage of the reform has coincided with the adoption of the Decree of the President of the Republic of Kazakhstan having the force of the “Law on Accounting” in 1995. The introduction of accounting standards of the Republic of Kazakhstan in 1996 developed on the basis of international accounting standards was the beginning of the transition to international financial reporting standards. The second and most important step in this process was the addition to this Decree of Article 2–1 “International Financial Reporting Standards in the Republic of Kazakhstan” in 2002.

“The Law on Accounting and Financial Reporting of the Republic of Kazakhstan” has adopted both, full IFRS Standards and the IFRS for SMEs. Further, the listing rules of the Kazakhstan Stock Exchange require that all listed companies must use IFRS Standards. In addition to listed companies, full IFRS Standards are mandatory for financial statements of large business enterprises and public-interest companies, including all financial institutions. Medium-sized business enterprises and state enterprises are required to use either full IFRS Standards or the IFRS for SMEs Standard. Small enterprises must choose between the IFRS for SMEs Standard and a national standard developed by MOF. It is common for Kazakhstan’s tax authorities to invoke national Tax Code provisions over International Financial Reporting Standards. At times, this can lead to double taxation, especially when employing IFRS standards for deducting expenses between a company’s home office and its branch office in Kazakhstan.

In the opinion of country practitioners, a number of issues and challenges when preparing financial statements using the IFRS for SMEs and the main constraints to the implementation of principle-based standards, such as IFRS and the IFRS for SMEs in Kazakhstan, are:

1. A lack of competent accountants and of knowledge on the IFRS for SMEs. An insufficient level of professional knowledge and, as a consequence, difficulties in applying professional judgment;
2. The need for legislative changes and adequate interpretations of standards;

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3. Challenges in applying professional judgment (as, for example, in the case of discount rates, depreciation rates, impairment testing etc.);
4. Translations into Russian and their availability, and accessibility of information;
5. Influence of tax rules over approaches applied in general purpose financial reporting.

The capacity of practitioners would need to be enhanced and the influence of tax rules and tax enforcement over the preparation of financial statements would need to be reduced for the IFRS for SMEs to be successfully implemented in Kazakhstan. As a result, a program to improve the capacity of tax enforcers as well as a study on the differences between tax rules and financial reporting standards may be needed before the IFRS for SMEs can be implemented.

Belarus: The commitment of the Republic of Belarus to IFRS Standards was made in the Belorussian Accounting and Financial Reporting Act of 12/07/2013, which requires implementation of IFRS Standards in Belarus from January 1, 2017(IASB, 2017). Regulation of the National Bank of the Republic of Belarus No. 185 dated 27 September 2007 has required all banks and nonbanking financial organizations to present their financial statements in conformity with IFRS Standards as issued by the IASB Board. In addition, the Belorussian Accounting and Financial Reporting Act of 12/07/2013 requires IFRS Standards for the financial statements of all public interest entities from January 1, 2017, with restatement of 2016 financial statements using IFRS Standards.

The Ministry of Finance of Belarus provides several problematic issues of implementing IFRS for SMEs in Belarus:

1. Restricted range of users for SME reporting;
2. Insufficient background and practical skills of SME staff and costs related to IFRS-based reporting (computer and software updates, staff advanced training, consulting and audit services, etc.) (IASB, 2017).

Entities will need to take into account several practical considerations when they prepare to apply the IFRS for SMEs:

1. Conducting a preliminary impact assessment in order to identify and understand the effect on the company's financial statements;
2. Setting out a clear strategy for conversion to the IFRS for SMEs;
3. Considering first-time adoption exemptions so as to facilitate a cost-effective transition to IFRS for SMEs reporting;
4. Understanding the underlying principles and objectives of the standard and how they are applied.

Therefore, a phased approach is recommended for implementation of IFRS for SMEs at the entity level. The main three phases are:

(1) A preliminary study to allow the company to understand the impact of IFRS for SMEs on key indicators and ratios and draw attention to key accounting issues and any other potential, surprises. (2) Initial conversion, which could be implemented in two steps: (i) financial statements components evaluation and issues resolution which will result in fully-informed decisions on the IFRS for SMEs accounting policies and conversion strategy, as well as on operational and systems changes, and (ii) initial financial reporting conversion. It is recommended that the first comprehensive financial statement prepared in line with the IFRS for SMEs requirements is not reported externally, so that the business and management can see itself in the new IFRS for SMEs for the first time. (3) Incorporating the change which would enable an entity to make a smooth transition to a new way of operating, using the new IFRS for SMEs language comfortably and authoritatively. It is very important to stress that a successful transition to the IFRS for SMEs requires firms to focus on several streams (changing the information reported, changing people and processes, and adapting information systems) simultaneously in each of these phases. The priority attached to each stream will gradually change as progress is made.

IFRS Adoption for SMEs in Georgia and the Challenges Faced by SMEs in Georgia through the Adoption

The SMEs contribution to growth and employment is widely recognized. Small and medium-sized companies promote export, are drivers of innovations. They develop the welfare of the country, SMEs contribute to raising the living standards of society by stimulating economic activity, diversity of products offered to consumers and creating new jobs (Sorin, 2013). In the EU countries, SMEs accounted for 99.8 percent of all enterprises active non-financial business sector, 66.8 percent of total employment and 58.1 percent of the value added (Europian Comission, 2014, p. 14).

Small and medium-sized enterprises play particularly important role in developing countries, such as Georgia. Formal SMEs contribute up to 45 percent of total employment and up to 33 percent of national income (GDP) in emerging economies. These numbers are significantly higher when informal SMEs are included (Bell, 2015).

The contribution of small and medium-sized companies in the economy of Georgian 2010-2015 is shown below:

Table1. The Share of SMEs in Total Value Added (mln. GEL), According to the New Methodology

Year	Total	Medium sized	Medium sized %	Small	Small %
2010	6,703.2	1,684.2	25%	1,694.7	25%
2011	9,253.7	2,221.0	24 %	2,918.5	32%
2012	11,190.7	2,835.5	25%	3,367.2	30%
2013	12,139.1	2,994.2	25%	3,799.9	31%
2014	12,849.4	3,094.3	24%	4,263.1	33%
2015	14,761.0	3,674.0	25%	4,903.8	33%

Source: Geostat, 2016

Medium-sized firms contribute 25% of value added, on average and small-sized firms contribute 31% on average in 2010-2015 (Table 1).

Table 2.Share of SMEs in Employment, According to the New Methodology

Year	Total	Medium sized	Medium sized %	Small	Small %
2010	397,806	104,274	26%	161,665	41%
2011	503,236	118,688	24%	231,305	46%
2012	534,397	118,022	22%	246,931	46%
2013	550,885	125,925	23%	246,538	45%
2014	592,147	126,432	21%	279,205	47%
2015	626,739	137,171	22%	290,982	46%

Source: Geostat, 2016

In 2010-2015, the share of medium-sized entities in employment is 23% on average, and the share of small-sized firms is on average 41% (Table 2).

Table 3. Production Value (mln. GEL) According to the New Methodology

Year	Total	Medium sized	Medium sized %	Small	Small %
2010	13,303.7	3,364.2	25%	3,205.0	24%
2011	19,239.9	4,754.5	25%	5,553.6	29%
2012	23,096.0	6,098.6	26%	6,432.5	28%
2013	23,553.6	5,998.7	25%	7,187.5	31%
2014	26,068.6	6,571.3	25%	8,309.1	32%
2015	29,993.9	7,873.5	26%	9,600.4	32%

Source: Geostat, 2016

In 2010-2015, the share of medium-sized entities in production value is 26% on average and the share of small-sized firms is on average 29% (Table 3).

The new Tax Code of Georgia stipulates a new specification of businesses in Georgia as micro, small, medium, and large, based on workforce and annual turnover output (Table 4).

Table 4. The Definition of SMEs According to New Methodology

	Medium-sized	Small
Number of employees, for a calendar year	50-250	50
The maximum total turnover (mln. GEL)	12-60	12

Source: Geostat, 2016

In December 24, 2015, according to the law of the Georgian parliament, it was defined that from 1st January of 2017, entities should use the translated version of IFRS, IFRS for SMEs, International Standards for Auditing (ISA) and the last publication of IESBA Code, in purpose to an accounting and financial audit (Deloitte, 2015). According to the law "on accounting and financial audit", the standards of accounting include state and private sector accounting standards. Accounting standards of a private sector include international financial standards, IFRS for small and medium-sized enterprises, and the local standards for financial statements of non-commercial juridical firms. The finance ministry of Georgia defines standards for the state sector (Law of Georgia on Accounting and Financial Audit, 2016). According to the Law of Georgia, about auditing and accounting, SMEs have the right to use a full IFRS or the IFRS for SMEs (Law of Georgia on Accounting and Financial Audit, 2016).

The IFRS for SMEs is a self-contained standard designed to meet the needs and capabilities of small and medium-sized entities. It is simplified IFRSs, but built on an IFRS foundation. There are different views about the advantages and disadvantages of IFRS for SMEs in Georgia. According to the Georgian government report, about the "Strategy of Developing the SMEs in Georgia", The IFRS for SMEs, will increase the transparence of entities' financial statements(Governemnt of Georgia, 2016).

Conversion to IFRS is quite complex and costly, so it may be a big challenge for SMEs, as they will be impacted by the large transition costs and the high level of complexity of IFRS may not be absorbed by SMEs. In addition, small and medium-sized businesses do not have many resources to support implementing the changes. A survey of the FTSE 350 by PriceWaterhouse Coopers finds that they need to hire more professional accountants or other outside consultants to help them change (PWC, 2011).So, these will be another financial burden for the companies. Meanwhile these costs depend on the nationality of the company, its size and its sector. Just banks and large companies have been used the IFRS, till this moment in Georgia and small and medium-sized companies have been carried out the easier calculations. To implement IFRS for SMEs, will cause increased costs for SMEs. To adopt with the new model of profit tax, will take some time for taxpayers (Khavelashvili, 2017).

Research Methodologies and Data Collection

The study employs qualitative research methodology. In order to achieve research results, the study employed the following research tools: secondary and primary data analysis. Under secondary data analysis existing literature about IFRS for SMEs, the characteristics of the adoption process, the role of government and Georgian SMEs were studied and analyzed. Information was collected from a diverse source of documents and published data, such as, books, journals, websites, report of national and international organizations. All data were collected, verified and analyzed.

As for primary data analysis, the data about the attitude of SMEs in Georgia to the adoption of the IFRS for SMEs was collected through questionnaires. The questionnaire consisted of seven closed and open-ended questions and intended to collect the information about positive and negative impact of new regulation over performances of SMEs in

Georgia, as well as to identify the attitude of SMEs toward the process of adoption. In addition, the questionnaire intended to reveal the difficulties of new requirement and the opinion of SMEs in Georgia about the ways of overcoming difficulties they face.

15 representatives of SMEs in Georgia participated in the survey. The companies were selected from a private sector. Entities were randomly selected. None of the business companies rejected to cooperate and take part in the study. One employee from one company was selected for the survey. Overall, 15 people were questioned. Employees were purposefully selected. Respondents were auditors and accountants of organizations as well as the owners of business companies. Purposeful selection of employees aimed at ensuring informed answers to the questionnaire.

Research findings provided in the paper cannot be generalized, however, qualitative approach, employed by the study, allowed to study the research problem from different perspectives.

Data Analysis and Research Findings

Out of 15 small and medium sized entities questioned, seven were small-sized entities, and eight - medium-sized entities.

Respondents under the study were asked to highlight the impact of IFRS adoption in Georgia for SMEs. 13 %of respondents answered that the impact would be quite positive if the legislative base is adapted maximally to the financial standards. 27 % think that the financial position of the company will be more comparative and perceivable, brief and refined. 33% think that there will not be any positive impact on the business by adoption of IFRS. 27% of companies cannot assess the impact as they cannot see the full picture yet. After observing the consequences, one third of questioned representatives of SMEs reveals a negative approach to adopting the new standards. This means that the benefits from IFRS for SMEs is less for them than the difficulties, which the SMEs shall meet (see Figure 1).

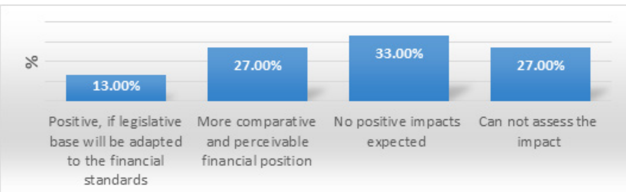

Figure 1. Impact of IFRS Adoption for SMEs in Georgia

As for the question of for whom the implementation of IFRS for SMEs is more useful, 60% of respondents marked out that the implementation of IFRS for SMEs will be useful for the government, 6% think that the implementation will be useful for the government, investor, company and the consumer of the product/service. 34% of SME representatives under the study think that just the investors will benefit from the process of implementation of IFRS for SMEs in Georgia. The majority of questioned SME representatives think that the government will have more benefits from the adoption of IFRS for SMEs. These benefits may be better control of small and medium-sized entities; increasing the economy of the country, by supporting SMEs to make business relations global; foreign investors gain as the IFRS for SMEs make the financial condition of companies more transparent. Although, according to SMEs under the study these opportunities cannot outweigh the difficulties they face through the adoption (see Figure 2).

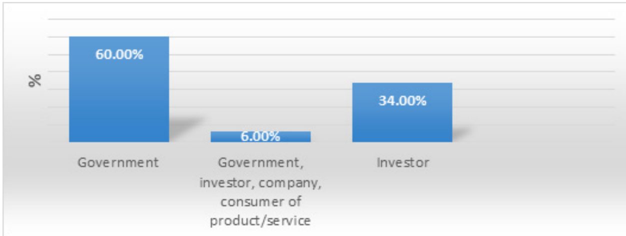

Figure 2. Parties for whom the Implementation of IFRS for SMEs in Georgia May Be Useful

The next question was aimed at detecting the problems, which small and medium-sized entities expect from the implementation of IFRS for SMEs in Georgia. 27%of SME representatives, under the study, marked out that there will be no difficulties, if the legislative base is maximally adapted to the standards. 6% of respondents pointed out that the financial costs will be increased. 40% think that accounting will be much more complicated. 27% cannot indicate any difficulties, because the standards have not been in practice yet. Almost half of the questioned SMEs pointed out that the new standards will just complicate the accounting and the employees will need support such as trainings and consultancies, to adopt the standards in practice (see Figure 3).

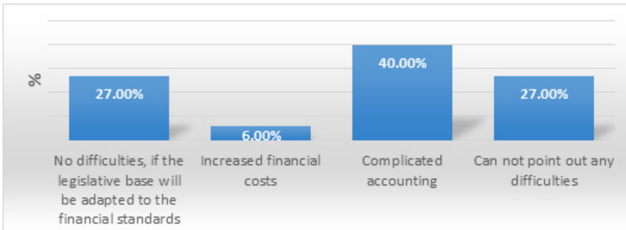

Figure 3. Challenges Faced by SMEs in Georgia through the Implementation of IFRS for SMEs

To the question, which of the standards is more difficult-to fulfill, 33 %of respondents pointed out the standard of statement of cash flow, because there is no good management to control the information about cash flow. 27% thinks that none of them is difficult, it is just very labor-intensive. 13% thinks that all standards will be difficult to fulfill. 7% cannot see any difficulties in fulfilling the standards. 20% of the companies have not answered to this question at all. One third of questioned representatives of SMEs marked out the statements of cash flow, as the most problematic standard. The cash flow management practices are not capable and sophisticated in these companies. There is no practice of managing the cash flow–related risks as well. Some of SMEs do not conduct financial transactions electronically and do not work with vendors, which also support electronic transactions. This sometimes causes data-entry errors and receiving the cash with delay. The solution can be implementing a good management system for cash flow control. If it is possible, all money transfers should be done electronically. There can be used special programs that can create budgets, calculate VAT, automate bill payments, and alert the companies to unusual outgoings. Using online invoices and reminders is also a powerful way to persuade reluctant clients to part with money (see Figure 4).

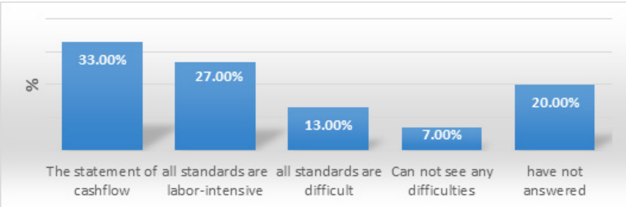

Figure 4. The Standards that Are the Most Difficult to Fulfill

Respondents suggested some ways to overcome the difficulties as well. 7%of respondent SMEs suggest that the best way to meet the challenges is to increase the awareness of businesses. 13% suggest that the government should pass the law, to simplify the working process for the companies. 13% of the companies think that the standards should be tightly related to the practice. 7% cannot suggest any ways to overcome the difficulties. 7% thinks, that the solution is to develop the business. 33%suggest that the practical experience is very important and 20 % thinks that the financial condition of the companies should be improved. The majority of SME respondents confirmed that they need more practical experience to adopt the standards easily. Quality and comparability comes along with the application of IFRS for SMEs, but the professionalism of accounting personnel, who prepare financial statements, is also very important (see Figure 5).

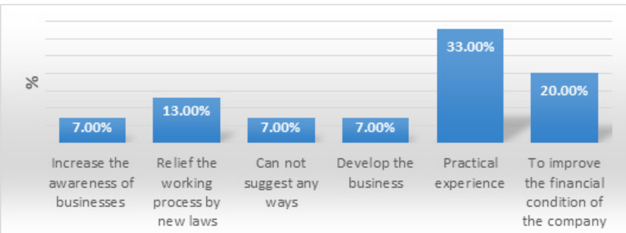

Figure 5. Ways Suggested by Respondent SMEs to Resolve Problems

To the question, if they need any support from the govenrment or from professional organizations to overcome the difficulties, 93%of respondents replied that the government should play an important role in this process and 7% replied that the government should not interfere at all. Majority of respondent entities think that the government should increase the awareness of companies regarding IFRS adoption for SMEs, because many companies are not even aware of what it is. Support from the government in the form of training on how to use IFRS for SMEs seems to be preferable for the majority of respondent SMEs (Figure 6).

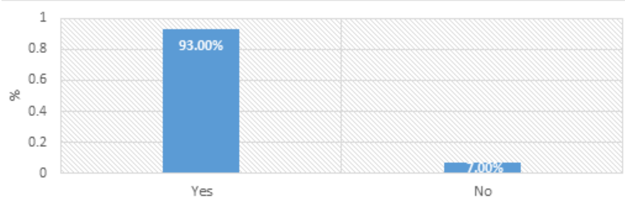

Figure 6. The Need for Support from Govenrment or from Professional Organizations

In general, 33% and 67% of the companies have negative and positive attitudes to the implementation of IFRS for SMEs, respectively. However, the positive attitude depends on how the legislative base will be adapted to the standards and how the government will take care of the small and medium sized entities to acknowledge the use of new standards and their easy adoption. Special programs should be offered by the government and professional organizations to support SMEs in the processes of adoption.

Conclusions

Conclusions and recommendations were drawn and framed based on both the analysis of reviewed literature and the analysis of research results and findings. Conclusions can be formulated as follows:

1. The IFRS for SMEs is still a complex set of standards, which requires sufficient number of well-trained professionals in order to prepare and audit financial statements, prepared according to the IFRS for SMEs;
2. Investigation of international practices show, that the decision to adopt IFRS for SMEs by developing countries, in particular, is influenced by economic growth; educational levels; degree of external economic openness; cultural considerations; existence of capital markets. The transition to IFRS for SMEs is very important step in the economic development of every country. The observation was done on five developing countries, which have already adopted IFRS for SMEs.In the countries under the observation, both companies and investors benefit from using the system, since investors are more likely to put money into a company, if the company's business practices are transparent. The presence of a complete set of accounting principles, simplified for each type of entity, increases the satisfaction of the financial statements' users by meeting their needs; provides a platform for enterprises, which are getting ready to enter the capital markets. Those who supported the IFRS for SMEs, highlighted the advantages for comparing financial statements prepared in different jurisdictions, which would encourage more cross-border trade and merger/acquisition activity and lower the cost of raising finance;

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3. Moving to IFRS for SMEs has some challenges as well. Whatever standard is chosen, some, if not all, companies have to adjust to it. Some small businesses using a perfectly good accounting system will be forced to incur costs to change to the new system. Opponents to the application of IFRS for SMEs in Europe, stressed the standard's complexity, particularly for small companies. For companies operating in just one country, that have no need for cross-border comparability, the extra burden, the standard imposed, would outweigh any potential benefits. It has also been one of the critiques of financial statements, that some people do not understand financial statements. Translation of standards to different languages is problematic because information may be lost in the process of translation. In addition, even though accounting standards would be standardized across countries, laws and other regulations would not, which could hamper the comparability of financial statements across countries, even when the same accounting system is being used;
4. International practices of overcoming the difficulties can be suggested to the developing countries, such as, Georgia. Several ways of troubleshooting the problems were highlighted: making rulebooks, guidance and supporting implementation, building capacity of individuals and institutions, involvement of regulators, professional bodies, accounting and audit community, universities and all other stakeholders in the process of completion of new systems. Making sure that all regulations (including IFRS, IFRS for SMEs) are applied in practice properly;
5. The conducted survey detected some positive impact of IFRS for SMEs from the point of view of respondent entities, if the legislative base is adapted to the financial standards. SMEs under the study think that financial position of the company will be more comparative and perceivable, brief and refined. However, the major part of companies claim that there will be many difficulties for the business and that the accounting will be much more complicated and labor-intensive. The standard about the statement of cash flow was considered as the most problematic aspect for respondent SMEs, because there is no good management to control the information about cash flow. The solution can be implementing a good management system for cash flow control. If it is possible, all money transfers should be done electronically. There can be used special programs that can create budgets, calculate VAT, automate bill payments, and alert the companies to unusual outgoings.
6. Almost all respondent SMEs confirmed that the government should play an important role in this process by increasing the awareness of businesses and helping them in developing their performances. Some of the SMEs are not even aware of what IFRS for SMEs is about. Efforts towards enhancing the awareness of IFRS for SMEs among the companies should be prioritized. This can be done by arranging seminars, training programs and conferences. The standards should be tightly related to the practice, the legislative base should be adapted to the IFRS for SMEs. New laws should be passed which can help small and medium-sized entities in the working process and to fit to new standards. In case the government fulfills all these requirements of the businesses, there is a positive attitude in general by respondent SMEs to the implementation process of IFRS for SMEs.
7. IFRS for SMEs should not be made mandatory for all SMEs in Georgia by the Georgian government/regulators, because IFRS for SMEs is still in its very early stages and the majority of the SMEs are not yet ready for the adoption. Financial reporting according to international standards should be mandatory only for those entities for which there is a need to prepare financial information founded on principles-based standards and where it is likely, that this information will be useful, especially, for investment and lending decisions, as the number of entities which carry out cross-border transactions and seek capital on the market is limited. In addition, the capacity of entities to bear the cost of producing financial statements should be taken into account.

One important issue that has to be finally highlighted is a study of the differences between tax rules and financial reporting standards before the IFRS for SMEs are implemented.

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