International Financial Reporting Standards and Performance of Selected Small and Medium Enterprises in Developing Countries; A Case of Uganda

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This proposal is submitted in partial fulfillment of doctoral degree in Business Administration

DECLARATION

I, **SERWANJA RONALD** hereby declare that this research work is my own authentic and original work, and has never been presented to any other institution for any academic award.

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APPROVAL

This is to certify that this research proposal has been written under our supervision and is now submitted for examination

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CHAPTER ONE

GENERAL INTRODUCTION

1.0 Introduction

This study entitled, "*International Financial Reporting Standards (IFRS) and performance of Small and Medium Enterprises (SMEs) in developing countries",* with Financial Reporting Standards as the independent variable and performance of Small and Medium Enterprises (SMEs) as the dependent variable. The focus on this study is being propelled by the unsatisfactory performance of SMEs in developing economies. In Uganda, preliminary survey indicates that there is a high rate of collapse of SMEs, an indication of unsatisfactory performance. For purposes of this study, the performance indicators of SMEs will include; profitability, shareholder values, compliance to tax policies. In the context of this study, IFRS will be measured in terms of conformity of accounts with IFRS, transparence of information for users and minimizing cost of financial management. The first chapter will focus on the background information highlighting the conceptual, historical/global perspective and contextual perspective. It will also high light the statement of the problem, purpose, objectives, research questions, scope, significance and conceptual framework. It also provided a basis on which other chapters were built.

1.1 Background to the Study

1.1.1 Historical Perspective

The history of IFRS is dated as far as 1974 by the International Accounting Standards Committee (IASC) which was based in London. The IASC was formed to address the need for standards that could be used by developing countries in formation of accounting standards. This was as a result of the development of global markets, the need of multinational companies for a uniform set of financial statements, and the demand for one common global reporting language (Amanda & Eddy, 2008). The Council for International Financial Reporting Standards Board (IASB) published in 2006 the scheme for the preparation of Financial Reporting Standards for SMEs, which was published in Romania, in 2009. It can therefore, be said that IFRS began in Europe because of high levels of business growth as compared to developing countries.

As pointed out by Antwi Kofi Gyasi (2010), most countries in the world have revolutionized their accounting practices especially during the last few decades of the 21st century. Such revolutions encompass the adoption of local accounting practices and harmonizing it with that of the International Financial Reporting Standards (IFRS), formerly known as International Accounting Standards (IAS). Countries like Nigeria have also entered the band wagon are implementing IFRS. For example, Nigeria embraced the IFRS in January 2012 (Wilson et al., 2013). The Nigerian Accounting Standard Board (NASB) formulates Accounting Standards (ASs) based on the IFRSs keeping in view the local conditions including legal and economic environment, which have recently been notified by the Companies, Allied and Matters Act 1990

Today more than 100 countries throughout the world, including 27 European Union member states, require or permit the use of International Financial Reporting Standards (IFRSs), developed by the IASB. The number of countries adopting IFRS was expected to increase to 150 by the end of 2011. Countries such as China and Canada have announced their intention to adopt. The Securities and Exchange Commission in India has issued a roadmap whereby a few big US corporations would begin reporting according to IFRS by 2014 (Ikpefan *et al*., 2012).

Today Uganda authorizes the use of IFRS in the country in 1998 (World Bank; Mwuara & Nyaboga, 2008). Before IFRS was legalized in Uganda companies used the standards set forth in the Companies act (1961). When the Uganda securities exchange limited rules were announced in 2003 all listed companies had to organize financial statements appropriate to national laws and IFRS. This brought Uganda into the third stage of the adoption process. Additionally, under the financial institutions act passed in 2004 all financial institutions had to formulate their financial statements in accordance with IFRS ((Ibid).

On the aspect of adaptation of IFRS in Uganda, the Council of Certified Public Accountants of Uganda (ICPAU) has adopted International Financial Reporting Standards (IFRSs, IASs, SIC and IFRIC Interpretations) as issued by the International Accounting Standards Board (IASB), without amendment, for application in Uganda (IFRS for SMEs). International Financial Reporting Standards set out recognition, measurement, presentation and disclosure requirements dealing with transactions and other events and conditions that are important in general purpose financial statements (Rodrigo, 2012)

The adoption of IFRS in Uganda to a larger extent is influenced by external factors such as foreign investors, international accounting firms, and international financial organizations among others. However, unless a country opens its doors to these institutions, there is little they can do to politicize the adoption process. The implication is that the more a country is opened to the international environment, the higher the possibility that the country would be coaxed into adopting International Financial Reporting Standards (Rodrigo, 2012).

However, according to the International Accounting Standards Board (IASB, 2009), the objectives of the IASC Foundation and of the IASB are: to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world"s capital markets and other users make economic decisions. IASB, 2009 also intends to promote the use and rigorous application of those standards; in fulfilling the objectives associated with (and to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies; and lastly to bring about convergence of national accounting standards and International Accounting Standards and International Financial Reporting Standards to high quality solutions.

Today, the IFRS for SMEs is a self-contained standard, incorporating accounting principles based on existing IFRSs which have been simplified to suit the entities that fall within its scope. There are a number of accounting standards and disclosures that may not be relevant for the users of SME financial statements. As a result the standard does not address topics such as earnings per share, interim financial reporting, segment reporting, insurance (because entities that issue insurance contracts are not eligible to use the standard) and assets held for sale. In addition there are certain accounting treatments that are not allowable under the standard. Examples of these disallowable treatments are the revaluation model for property, plant and equipment and intangible assets, and proportionate consolidation for investments in jointly controlled entities. Generally, there are simpler methods of accounting available to SMEs than those accounting practices, which have been disallowed (IASB, 2009).

1.1.2 Conceptual Perspective

Accounting is the language of business while financial reporting is the medium through which the language is communicated. Accounting and financial reporting are regulated by Generally Accepted Accounting Principles (GAAP) comprising of accounting standards, company law, and stock market regulations; and so on GAAP for accounting and financial reporting gives answers to differences in business communication between countries. The global GAAP that is seeking to unify accounting and financial reporting world is the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards (IASs; International Financial Reporting Standards (IFRSs); Standing Interpretations Committee (SICs) pronouncements; and International Financial Reporting Interpretations Committee (IFRICs) guidelines (Ikpefan *et al*, 2012).

According to the Kaplan and Bruns (1987) accounting is defined as the process of examining and analytically recording, in terms of money or some other unit of measurement, operations or transactions and summarizing, reporting and interpreting the results thereof. It embraces writing in the original/subsidiary books of entry, posting to ledger, preparation of trial balance and final accounts (Shayamapiki, 2005). Accounting is also a strategy for meeting legal requirements because it helps to comply with the various legal requirements. It is obligatory for joint stock companies to make and present their accounts in a recommended form. Various returns such as income tax, sales tax are prepared with the help of the financial accounts (Hayes, 2002).

According to David Chitty *et al*., (2010), the objective of IFRS is to ensure that an entity‟s first IFRS financial statements contain high quality information that is transparent for users and comparable over all periods prescribed, provides a suitable starting point for accounting under IFRS, and can be generated at a cost that does not exceed the benefits to users.

A number of scholars have conducted studies on SMEs, for example, Wayne Pease and Michelle Rowe (2003), conducted a study on the adoption of electronic commerce by Small and Medium Enterprises (SMEs) in regional Australia, University of Southern Queensland. Aminul *et al*., (2011), carried out a study on factors affecting business success of Small & Medium Enterprises (SMEs) in Thailand, while Sarut Jaidee & Nicholas Beaumont (2003), did a study on factors affecting SMEs‟ owners/managers in adoption of business-to-business techniques in Australia. However, the most important thing to note here is that, none of the scholars had conducted a study on how International Financial Reporting Standards (IFRS) impact on performance of Small and Medium Enterprises (SMEs) in developing countries with specific reference to Uganda, a gap which this study intends to fill.

Small and medium sized companies have an important position in the economy, mainly in the area of employment. SMEs are crucial to most developed and developing economies. SMEs are a heterogeneous group, possessing different size, sector, or location. Their activities on the international markets are limited by a great deal of obstacles in comparison to large enterprises. Different national financial reporting and tax systems can be considered as the most important obstacles (European Commission, 2003, cited in ohusova *et al*., 2011).

However, the definition of SMEs differs with jurisdiction (PricewaterhouseCoopers, 2009, cited in Adetula et al., 2014) and there is no consensus on the real definition of Small and Medium scale enterprises (SMEs) as the terms, „Small" and „Medium" are relative and they differ from industry to industry and country to country. Besides, no single definition can reflect the difference between firms, sectors and countries due to the varying level of development (Holt, 2009). Ekpenyong and Nyong (1992, cited in Adetula et al., 2014), claim there is no generally accepted definition of a SME because the classification of businesses into large-scale or small-scale is a subjective and of qualitative judgment.

As pointed out by Adetula et al., (2014), IFRS for SMEs is a revised and simplified version of full IFRS aimed at meeting the needs of private company financial reporting users and easing the financial reporting burden on private companies through a cost-benefit approach. IFRS for SMEs in itself is an independent international accounting and financial reporting standard that can be applied in the preparation of general purpose financial statements and other financial reporting by SMEs. IFRS for SMEs are developed by the International Accounting Standards Board (IASB).Although established with focus on the needs of a typical mid-size company, IFRS for SMEs may be used by any non-publicly accountable entity regardless of size.

1.1.3 Contextual Perspective

In the European Union, SMEs contribute to over 99% of all enterprises and 100 million jobs, representing 67.1% of private sector employment (International Financial Accounting Committee (IFAC), 2010). UK SMEs are mainly involved in the agricultural, commercial and building sectors. Looking at the African situation, SMEs in South Africa are engaged in community, social and personal services, finance, and real estate, wholesale and agriculture sectors. In Kenya the situation is not different from that in South Africa, for SMEs are involved in agricultural activities and commercial activities such as wholesale and retail businesses (ACCA, 2000).

According to the IFRS Foundation (2010, cited in Mazhindu et al., 2013), SMEs are estimated to epitomize more than 95 per cent of all entities. SMEs are useful in the sense that they contribute to most of the outputs and employment and are a basis for development of larger firms. SMEs also provide a basis for the overall development of a country, for example, IFRS Foundation (2010) adds that the most successful developing country over the last 50 years, Taiwan is built on a dynamic SME sector, for they have led to expansion of exports and provision of jobs. In Zimbabwe, SMES contribute to 60% of the total employment in the country (Nyoni, 2012).

In Uganda, SMEs are smaller and are involved in agro-business and other commercial activities, hotel business, insurance companies and micro-lending. Certainly, the SMEs have accounting records, though the focus of this study will be on the International Financial Reporting. However, the SMEs sector contributes 20% to Gross Domestic Product and it provides employment to over 1.5 million people which accounts for 90% of total non-farming private sector workers (UIA, 2008, cited in Abanis *et al*., 2013). The benefits of the small and medium enterprises in Ugandan economy cannot be overemphasized. Small and medium enterprises play Very significant role in employment and income generation, producing import substituting products, mitigating rural-urban drift and mobilization of local resources (Ernst and Young, 2011, cited in Abanis *et al*., 2013).

As pointed out by Okello (2011), the development of the SMEs has long been regarded as crucial for the achievement of broader development objectives, including poverty alleviation, economic development and the promotion of more democratic and pluralist societies. It is imperative that business information such as use of IRFS be effectively studied to find out how it influences SMEs performance. For their progress, SMEs are required to keep books of accounts irrespective of their size and are bound by the rules of Uganda to acceptable set of accounting principles (Muwanika *et al*, 2011).

In 1998, the Council of the ICPAU approved International Financial Reporting Standards (then known as International Accounting Standards) issued by the International Accounting Standards Board (IASB) as the national standards of Uganda (http://www.icpau.co.ug). This study is intended to find out impact of International Financial Reporting Standards (IFRS) on performance of Small and Medium Enterprises (SMEs) in Uganda.

Basing on the views by IFAC (2010), ACCA (2000), IFRS Foundation (2010) and Nyoni (2012), SMEs play a global contribution in output and job creation. It can also be pointed out improving the performance of SMEs through studying the contribution of IFRS to their development is of paramount importance as this will help to come up with strategies of enhancing performance using accounting systems.

In a survey conducted by the International Federation of Accountants (IFAC), a large majority of accounting leaders from around the world agreed that a single set of international standards is important for economic growth (http://www.ifac.org/globalsurvey). Based on these reviews, it is therefore, important to conduct a study the impact of International Financial Reporting Standards (IFRS) on performance of Small and Medium Enterprises (SMEs) in developing countries.

1.2 Statement of the Problem

Use of the IFRS for SMEs around the world is growing rapidly (Grant Thornton International Ltd, 2010). Uganda has had to adopt IFRS for all entities and wants simplified international standards because these are too complex for SMEs.

SMEs are also expected to adopt IFRS in order to be competitive in the global market. This brought Uganda into the third stage of the adoption process. Furthermore, under the financial institutions act enacted in 2004 all financial institutions had to prepare their financial statements in accordance with IFRS (World Bank; Mwuara & Nyaboga, 2008). Despite the stated developments of IFRS, many SMEs do not live for a long time, for others perform below capacity (UIA, 2014). In addition, little effort is being made to encourage the adoption of IFRS for SMEs by the policy makers within developing economies. Benefits that could accrue to SMEs that would have adopted the IFRS for SMEs would be better decision-making leading to growth through better accountability and compliance with tax legislation (Mazhindu et al., 2013). This study will therefore, make an investigation of the impact of International Financial Reporting Standards (IFRS) on performance of Small and Medium Enterprises (SMEs) in developing countries with specific reference to Uganda.

1.3 General Objective

To investigate the impact of International Financial Reporting Standards (IFRS) on performance of Small and Medium Enterprises (SMEs) in developing countries with specific reference to Uganda.

1.4 Specific Objectives

This study will be guided by the following specific objectives:

i. To ascertain the relationship between International Financial Reporting Standards and profitability of SMEs in Uganda
ii. To ascertain the relationship between International Financial Reporting Standards and shareholders value creation of SMEs in Uganda
iii. To ascertain the relationship between International Financial Reporting Standards and compliance to tax policies of SMEs in Uganda
iv. To ascertain the relationship between International Financial Reporting Standards on timeliness of financial reporting of SMEs in Uganda

1.5 Statement of Hypotheses

This study will test the following null hypotheses:

i. There is no significant relationship between International Financial Reporting Standards and profitability of SMEs in Uganda
ii. There is no significant relationship between International Financial Reporting Standards and shareholders value creation of SMEs in Uganda

iii. There is no significant relationship between International Financial Reporting Standards and compliance to tax policies of SMEs in Uganda

iv. There is no significant relationship between International Financial Reporting Standards on timeliness of financial reporting of SMEs in Uganda

1.6 Scope of the Study

Content Scope

The study will focus on the impact of International Financial Reporting Standards (IFRS) on performance of Small and Medium Enterprises (SMEs) in developing countries with specific reference to Uganda. Specifically, the study will ascertain the relationship between International Financial Reporting Standards and profitability, shareholders value creation and compliance to tax policies of SMEs in Uganda.

Area Scope

The study will be conducted in Kampala city because it is the business center of Uganda. Kampala city is also a home to many SMEs which have adopted IFRS in the Uganda as compared to other parts of the country.

Time Scope

The study will be based on literature about IFRS in Uganda for a period of sixteen years, that is from 1998 to 2014. The year 1998 has been chosen as a base year because it is when Uganda authorized the use of IFRS in the country (World Bank; Mwuara & Nyaboga, 2008).

1.7 Justification

In this era of globalization, Uganda is expected to transform its business technology to meet international standards and one of such business creations is adoption of IFRS for it‟s SMEs. While the country has authorized the use of IFRS in the country, there is need for further investigation to find out how this international innovation have enhanced performance of SMEs in Uganda. Uganda is also one of the developing countries with high rate of failure of SMEs (UIA, 2014) hence the need to find out if this is associated to the introduction of IFRS.

1.8 Conceptual Framework

INDEPENDENT VARIABLES

IFRS

- Conformity of accounts with IFRS
- Transparence of information for users
- Cost of financial management

DEPENDENT VARIABLES

Performance of SMEs

- Profitability,
- Shareholder values,
- Compliance to tax policies
- Timeliness of financial reporting

Intervening variables

- Lack of capacity
- Limited financial capital, competent and qualified personnel

Source: Developed by the Researcher Based on the views of Ikpefan *et al*., 2012:299

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

During the past few decades, the accounting literature has looked more closely into whether smaller non-public companies should be held accountable according to the same financial reporting standards as large and/or public companies (e.g. Evans & di Pietra et al., 2005; Jarvis, 1996; Keasey and Short, 1990, cited in Annika Ystrom, 2010). This issue has propelled tha researcher to investigate the impact of International Financial Reporting Standards (IFRS) on performance of Small and Medium Enterprises (SMEs) in developing countries with specific reference to Uganda.

However, as pointed out by Huifa Chen (2010), there are currently two main schools of thought in the debate on International Financial Reporting Standards (IFRS) and accounting harmonization/convergence. The proponents contend that a single global set of accounting standards helps reduce information asymmetry, lower the cost of capital, and increase capital flow across borders. The opponents argue that the characteristics of local business environments and institutional frameworks determine the form and contents of accounting standards. This chapter focuses on what other scholars have written about the impact of International Financial Reporting Standards (IFRS) on performance of Small and Medium Enterprises (SMEs) in developing countries. The literature has been classified in form of theoretical literature and empirical literature.

2.1 Theoretical Literature

This study will be based on the agency theory as stated by Iatridis, 2010). According to the agency theory it would suggest that by adopting IFRSs, firms act optimally and promote financial reporting quality and investor interests (Fields, Lys & Vincent, 2001, cited by Iatridis, 2010). For example, highly leveraged firms would be keen to adopt IFRSs in order to satisfy the needs of lenders and the requirements of debt covenants and /or avoid political attention and scrutiny (Lambert, 2001, cited by Iatridis, 2010). This theory is relevant because in the same way, the study will help to analyze financial reporting quality and investor interests in Uganda.

Healy (1985 also cited by Iatridis, 2010) suggests that the flexibility allowable in financial reporting may cause managers to behave opportunistically. This would imply that managers might manage the reported earnings in order to demonstrate a favourable transition to IFRSs or to avoid adverse implications on their profit figures and debt-paying ability (Watson, Shrives & Marston, 2002, cited by Iatridis, 2010).

This study will also be based on the economic theory of networks as indicated by Karthik *et al* (2009). According to Karthik *et al* (2009) the decision to adopt IFRS can be analyzed as a decision to adopt a product with network effects. To see this, note that accounting standards like IFRS are likely to be more appealing to a country if other countries have adopted them as well. This suggests we can use insights from the economic theory of networks to develop hypotheses on why countries choose to adopt IFRS. Network theory suggests that there are generally two factors to consider in adopting network-dependent products: the intrinsic value of the product and the value of the product"s network (Katz and Shapiro, 1985, cited in Karthik *et al*., 2009).

Academic theories yield mixed predictions on whether the adoption of IFRS is beneficial to a country. Some scholars have argued that international harmonization in accounting can improve capital-market efficiency: a common set of international accounting standards can reduce the information processing and auditing costs to market participants (Barth, 2007; 2008, cited in Karthik *et al*., 2009). Other academics argue that accounting standards evolve in the context of domestic cultural, legal, and other institutional features (including auditing): international harmonization in accounting, if it is not accompanied by changes to related capital market institutions, can be costly (Ball *et al*., 2000; Ball *et al*., 2003; Ball, 2006 also cited in Karthik *et al*., 2009). In the context of this study, all the stated theories will be used because of their applicability.

2.2 Empirical Literature

Under empirical literature, the section has been structured in accordance with the objectives of the study, that is, the relationship between IFRS and profitability, shareholder values, compliance to tax policies of SMEs.

2.2.1 International Financial Reporting Standards and profitability of SMEs

The literature reviewed under this section indicates that despite the advantages of IFRS, this business technology has been found to be costly to SMEs in developing countries which in turn have affected the level of profitability of the firms. For example, while Bertoni *et al,* year missing) further asserts that one of the main benefits from having a global set of standards for SMEs is the increased international comparability of financial reporting, the cost of adoption is high and this has a direct impact on the profitability of the business entity.

However, as indicated by Ikpefan *et al*., (2012), listed companies have a lot of benefits to derive from conversion to IFRS. Companies do not operate in isolation. Therefore, in the present global environment, compliance with foreign reporting requirements will help streamline their financial reporting. This will help minimize reporting costs as a result of common reporting systems and consistency in statutory reporting. Secondly, it will enable comparison or benchmarking with foreign competitors possible. Besides, adoption of IFRS may offer companies an edge over competitors in the eyes of users. Thirdly, since the adoption of IFRS will transcend national boundaries or cross border, acquisitions and joint venture will be made possible and there will also be easy access to foreign capital. Fourthly, companies can trade their shares and securities on stock exchanges worldwide (Ikpefan *et al*., 2012). As far as this study is concern, these mentioned benefits can culminate into increased sales and hence profitability of the SMEs.

Bertoni *et al*., (2013:6) disagrees with Ikpefan *et al*., (2012) and asserts that full compliance with IFRS is considered to be excessively burdensome and expensive for SMEs (although in some countries IFRS are applied by all entities, no matter the size) therefore the proposed IFRS for SMEs introduce several simplifications. Given the mandatory fallback to full IFRS for those topics not covered by IFRS for SMEs, simplification is partly achieved by omitting from the proposed IFRS for SMEs some issues.

Thornton (2011) supports Bertoni *et al*., (2013:6) and adds that the IFRS for SMEs is based on full IFRS, but acost-benefit approach has been taken in order to reduce the burden on SMEs. Many IFRS recognition and measurement requirements have been omitted or simplified and topics not relevant to SMEs have been omitted. The IFRS for SMEs is around 10% of the length of the consolidated text of International Financial Reporting Standards and has about 10% of the disclosure requirements. An entity is publicly accountable if it files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market, or if it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (for example, banks, insurance companies and mutual funds). An entity that holds assets in a fiduciary capacity for reasons incidental to its primary business (for example, travel or real estate agents) is not considered to be publicly accountable. A subsidiary that is part of a consolidated group that uses full IFRSs may still use the IFRS for SMEs in its individual financial statements where the subsidiary itself does not have public accountability. It must follow the standard in its entirety however and cannot pick and choose between the requirements of the IFRS for SMEs and those of full IFRSs (Thornton, 2011).

According to the United Nations (2008, cited in Bohusova *et al*., 2011) the concept of applying global reporting standards to SMEs in developing countries is believed to be more difficult than elsewhere. Oberholster (1999, cited in Bohusova *et al*., 2011) found that the unique challenges and the heterogeneous nature of developing countries are not necessarily accommodated when International Accounting Standards are adopted by these countries. According to Correa-Cortes (2008, cited in Bohusova *et al*.,2011), SMEs from developing countries find it more difficult to cope with typical SME challenges such as limited financial and human resources. Zeghal & Mhedhbi (2006,cited in Bohusova *et al*.,2011) suggested that the decision to adopt IFRS by developing countries, in particular, is influenced by; economic growth, educational levels, the degree of external economic openness, cultural considerations and existence of active capital markets.

Marjan (2004) acknowledges the impact of IFRS and points out that launching International Accounting Standards ought to improve firms‟ performance in many ways. For example Houston and Reinstein (2001, cited in Marjan, 2004) asserts that international accounting harmonization will slim down the costs of doing business, particularly across national borders, than will contribute towards greater efficiency of the market regulations and will reduce the costs for conducting financial statements analysis and investments in international context. The reduction in costs will in turn help to increase on the profits of the firm.

According to Takatsugu Ochi (2014), by adopting IFRS, all companies will be free from such restrictions and gain various options, such as cross-border fund procurement, capital tie-ups and business collaborations. Moreover, the advantage of using a uniform IFRS yardstick will help multinational companies with consolidated subsidiaries abroad standardize management barometers and achieve uniformity of control, thereby enhancing the quality of managerial infrastructure that is essential in strengthening their international competitiveness. In the context of this study, these activities can in turn increase the profit margins of firms including SMEs.

2.2.2 International Financial Reporting Standards and shareholder values of SMEs

The focus on this section was due to the fact shareholders are concerned with enhancing the firm's earnings, increase the market value of its shares, and escalation the amount or frequency of the dividend paid (www.businessdictionary.com).This study therefore, will seek to find out the relationship between IFRS and shareholder values of SMEs. This is supported by Ballow et al, (2004) who indicates that IFRS can help stakeholders to acquire a right picture of shareholder value. They add that IFRS can considerably increase transparency across all asset classes. The exposure of a true picture of shareholder value is a key component of business management and can enhance stakeholders‟ confidence in the business.

According to Paul et al., (2014), advocates of IFRS assert that IFRS raises financial comparability and usefulness of accounting information. For example, since 2005, all listed companies in the EU are required to prepare their consolidated financial statements in accordance with IFRS. Subsequently, they have become mandatory in Australia, Canada, Brazil, Korea and many other countries. The study by Paul et al., (2014) generally indicate that most companies which were complying with the IFRS were performing better in terms of sales turn over in all the stated countries as compared to their counterparts who have not yet adopted IFRS. This also means that there was increase in shareholders‟ equity.

2.2.3 International Financial Reporting Standards and compliance to tax policies of SMEs

The extension of IFRS to individual accounts, limited in practice to a small number of EU countries, is particularly problematic in civil code countries, where a company‟s individual accounts have a legal relevance for taxation, the determination of distributable income, and other company law and insolvency issues. Introduction of IFRS in contexts will inevitably require a legislative adaptation, in order to adjust tax and company law to the new accounting standards (Bertoni *et al,* year missing: p5).

The international financial reporting standards are an effective tool for increasing the transparency and understandability of the information on business affairs of economic entities. The indicators presented in the financial statements are a source for creating a database to recognize incomes and expenses. They help valuate assets and liabilities, provide a possibility for objective disclosure of financial risks, and compare the results of enterprises‟ activity in dynamics in order to ensure the adequate assessment of the potential and to make the relevant management decisions (Iryna P. Sklyaruk, 2012:371). The integral constituent of the accounting and financial statements is accounting of incomes and expenses of economic entities, which is to be further investigated and perfected in terms of their definition, coordination and presentation in accordance with IFRS (Iryna P. Sklyaruk, 2012:371). It is strongly believed that the primary reason for financial reporting is to ensure that the stakeholders of a company are able to hold management accountable for the financial position and performance of the company (Samujh, 2007:8).

Financial statements based on the present set of IFRS are designed to reduce information asymmetries between the „insiders" of a reporting entity and the various „outsiders" making economic decisions involving that entity. Since outside interests differ, financial statements need to be general purpose. Their first and overriding objective is to provide the outsiders with information to improve their economic decision making (Alexander, 2007)

The application of the current Framework to SMEs, on the other hand, appears problematic; insofar many SMEs do not have outside investors. Users of financial statements of SMEs are certainly a narrower group than those of entities with public accountability. An Italian survey (Paoloni & Demartini, 1997) showed that the main users of SMEs" financial statements are (in order of relevance): 1) tax authorities; 2) banks; 3) investors not involved in the day-to-day management of the business; 4) customers and suppliers; 5) employees. Similar results were found the same in other countries (Evans *et al.*, 2005).

Proponents of IFRS argue that the standards reduce information costs to an economy, particularly as capital flows and trade become more globalized, it is cheaper for capital market participants to become familiar with one set of global standards than with several local standards (Leuz, 2003; Barth, 2008, cited in Karthik 2009).

2.2.4 International Financial Reporting Standards on timeliness of financial reporting of SMEs

In a study conducted by Iyoha (2012) titled, "*Company Attributes and the Timeliness of Financial Reporting in Nigeria",* it was revealed that there is a growing need for timely information stakeholders who have operating interest in the company. Iyoha (2012) further contends that in Nigeria, the requirement for high quality and timely financial information has become predominantly imperative due to the increasing exposure of Nigerian business organizations to global capital market. In the context of this study, it can be said that while the views of Iyoha (2012) are convincingly correct, there is need to find out how the IFRS have enhanced timeliness of financial reporting of SMEs and for this case with reference to SMEs in developing countries with particular interest in Uganda.

Accounting standards and preparer incentives interact to produce accounting information. Financial reporting practice under a given set of standards is sensitive to the incentives of the managers and auditors responsible for the preparation of financial reports (Ball et al. 2003, cited in Huifa Chen et al, 2010). Ball et al (2003) show that high quality standards do not necessarily produce high quality accounting information, For example, financial reporting in four East Asian countries (regions) of Hong Kong, Malaysia, Singapore, and Thailand is generally in low quality, even though their standards are derived from common law sources (UK, US, and IAS) that are widely viewed as higher quality than code law standards. They conclude that this is due to poor preparer incentives and that reporting quality ultimately is determined by the underlying economic and political factors influencing managers‟ and auditors‟ incentives, and not by accounting standards per se (Ball et al. 2003; Jeanjean and Stolowy 2008, cited in Huifa Chen et al., 2010).

Adetula et al., 2014 further indicates that the major reason for the adoption of the draft IFRS for SMEs was the urgent need for auditors to express an opinion on financial statements which are prepared in accordance with an accepted framework of the auditing profession in South Africa. The second major reason for the adoption was to provide a beneficial framework for the preparation of the financial statements.

2.3 Conclusion

The literature on International Financial Reporting Standards and performance of SMEs is very scanty particularly in developing countries like Uganda .Nevertheless, lessons will be drawn from developed countries to compare whether the situation in Uganda is different or not from the empirical literature from the stated scholars.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter explains the approaches that will be used to get information on the research problem. It comprises of the research design, study population, sample size and selection, sampling techniques and procedure, data collection methods and instruments, procedure of data collection, data analysis and measurement of variables. It also indicates the problems anticipated in the study.

3.1 Research Design

This study will be cross-sectional research design because it will focus on a cross-section of SMEs in Uganda who are using International Financial Reporting Standards. Cross-sectional research is advantageous because it does not require follow-up and is therefore less costly and quicker than other designs. Samples are often representative of a population, rather than a smaller sub-population (MI-CPHP, 2010).

This study will adopt a quantitative approach which involves the generation of data in quantitative form which can be subjected to rigorous quantitative analysis in a formal and rigid fashion (Kothari, 2004). The study will also adopt a Qualitative approach to research which is concerned with subjective assessment of attitudes, opinions and behaviour. Research in such a situation is a function of researcher‟s insights and impressions. Such an approach to research generates results either in non-quantitative form or in the form which are not subjected to rigorous quantitative analysis. Generally, the techniques of focus group interviews, projective techniques and depth interviews are used (Kothari, 2004).

3.2 Study Population

The study population will include the business owners, their accountants, Finance managers and auditors of SMEs. Specifically, the study will focus on main stream SMEs, Auditing Firms and hotels which are less than three stars and those other SMEs which have been using IFRS in their financial reporting since 1998 when the financial institutions act passed to 2014 to be able to see the impact of IFRs during this period. The Auditing firms will be included because they are from time to time involved in auditing books of accounts of other firms.

Sample Determination Table

Category of Respondents	Population	Sample	Sampling procedures
Main stream SMEs in Kampala Central	100	80	Purposive
Consultancies	30	28	Purposive
Hotels	20	19	Purposive
Total	150	127	

Guided by UIA (2013) estimates and Morgan and Krejcie (1970) sample determination table

3.3 Sampling Procedures

The sample will be determined by Morgan and Krejcie (1970).

3.4 Data Collection Methods/ Instruments

The data collection methods and research instruments that will be used during the process of data collection will include, questioning and interviewing supported by questionnaires and interview guides.

3.5 Data Collection Using Questionnaires

The data collection methods and research instruments that will be used during the process of data collection will include; questioning and interviewing supported by questionnaires and interview guides. The questionnaire will be designed in accordance with the objectives of the study. Some of the questionnaires will be close-ended while others will be open ended. Close ended questionnaires will be used because they are probably the type with which most respondents are most familiar. In addition, these types of questionnaires are used to generate statistics in quantitative research and are easy to analyze using computer analysis tools (Dawson, 2009). On the other hand, open-ended questionnaires will be open-ended and will be used in obtaining qualitative data. Such questionnaire will not contain boxes to tick, but instead blank section will be left for the respondent to write in an answer (Dawson, 2009). According to Amin (2005), questionnaires are popular with researchers because information can be obtained fairly, easily and the questionnaire responses are easily coded. However, the major weaknesses of questionnaires are that they do not provide detailed information to the problem and this is why they will be substantiated by interviews.

3.6 Data Collection Using Interviews

Interviews will be used and the interview guide will also be prepared in accordance with the objectives of the study. In-depth interviews will be used because it is easy to fully understand someone's impressions or experiences, or learn more about their answers to questionnaires. According to Mugenda & Mugenda (1999), interviews are advantageous in that they provide in-depth data, which is not possible to get using questionnaires.

3.7 Validity and Reliability of Instruments

Validity

Validity is the extent to which an instrument measures what it purports to measure (Carolel et al., 2008). Validity of instruments will be ascertained by first discussing the questionnaire and interview schedule drafts with the supervisors. The content validity of the instrument will be found worthy executing for the pilot run and thus the study. After constructing the questionnaire, the researcher will contact the supervisor and three other experts in order to get expertise judgment on the validity. The following formula will be used to test the Content Validity Index (CVI) as indicated by Denise F. Polit (2006:493).

$$\text{CVI} = \frac{\text{Number of items regarded relevant by researcher}}{\text{Total number of items}}$$

The instruments will be said to be valid when the CVI of 0.5 or above 0.5.

Degree of Accuracy (Construct Validity Test)

Mean Range	Interpretation
Below 0.50	Not Acceptable
0.50 to 0.699	Acceptable
0.70 to 0.799	Good
0.80 to 0.899	Great
Above 0.90	Superb

Source: Denise F. Polit (2006:493).

Degree to which the research instrument measures ensures that the questions asked relate to the construct intended to be measured

Reliability

Reliability is the degree to which measures are free from error and therefore yield consistent results (i.e. the consistency of a measurement procedure). If a measurement device or procedure consistently assigns the same score to individuals or objects with equal values, the instrument is considered reliable. Reliability involves the consistency or reproducibility of test scores i.e., the degree to which one can expect relatively constant deviation scores of individuals across testing situations on the same or parallel testing instruments (Ganesh, 2014).

3.8 Data Analysis

Analysis of Quantitative Data

The researcher will use content data analysis which according to Satu Elo & Helvi Kynga (2007) aimed at building a model to describe the phenomenon in a conceptual form. Both inductive and deductive analysis processes will be represented at three main phases: preparation, organizing and reporting. The preparation phase is similar in both approaches. The concepts are derived from the data in inductive content analysis. Deductive content analysis is used when the structure of analysis is operationalized on the basis of previous knowledge.

The frequency and percentage distribution will be used to determine the demographic characteristics of the respondents. While the mean and standard deviations will be applied for the various levels. An item analysis will illustrate the strengths and weaknesses based on the indicators in terms of mean and rank. From these strengths and weaknesses, the recommendations will be derived.

The relationship between International Financial Reporting Standards (IFRS) on performance of Small and Medium Enterprises (SMEs) in developing countries will be evaluated using

Pearson‟s correlation co-efficiency. The correlation coefficient at all times takes a value between -1 and 1, with 1 or -1 indicating perfect correlation. A positive correlation shows a positive association between the variables, while a negative correlation indicates a negative association between the variables. A relationship value close to 0 indicates no association between the variables.

Use of descriptive statistics

The stated variables in the questionnaires will be analyzed using descriptive statistics of responses categorized as followed:

Strongly disagree	Disagree	Neutral	Strongly Agree	Agree
1	**2**	**3**	**4**	**5**

Using descriptive statistics, the mean values of 3 and above will be high levels of agreement with the statement while mean values of less than 3 will manifest high levels of disagreement with the corresponding statements as per the questionnaire.

A multiple correlation coefficient will be used to test the hypothesis on correlation at 0.05 level of significance using a t-test will be employed. The regression analysis R^2 (coefficient of determination) will be computed to determine the influence of the dependent variable on the independent variable.

Analysis of Qualitative Data

As pointed out by David R. Thomas (2003), this will be based on a general inductive approach whose purposes are (1) to condense extensive and varied raw text data into a brief, summary format; (2) to establish clear links between the research objectives and the summary findings derived from the raw data and (3) to develop a model or theory about the underlying structure of experiences or processes which are evident in the raw data. The inductive approach is advantageous because it reflects frequently reported patterns used in qualitative data analysis.

The underlying assumption of inductive approach is that data analysis is determined by both the research objectives (deductive) and multiple readings and interpretations of the raw data (inductive). Thus the findings are derived from both the research objectives outlined by the researcher(s) and findings arising directly from the analysis of the raw data (David R. Thomas (2003).

3.9 Ethical Considerations

The researcher will take into consideration a number of ethical issues including:

i. Confidentiality of respondents shall be kept, They will not be required to reveal their names nor their contacts on the questionnaires. Identification numbers will be used assigned instead of names to avoid information given being traced to a respondent.
ii. Organizational identity and other critical information will also be kept strictly confidential.
iii. All data gathered shall be used only for the purpose of this study and nothing else.
iv. The research procedures shall be explained to all the respondents before they take part in the research and their informed consent obtained.
v. All the sources of literature shall be acknowledged throughout the whole study through proper citations and referencing.
vi. Personal bias will be avoided during the entire study i.e. during interviews, data analysis and reporting.

3.10 Limitations of the Study

In view of the following threats to validity, the researcher will claim an allowable 5% margin of error at 0.05 level of significance. Measures are also indicated in order to minimize if not to eradicate the threats to the validity of the findings of this study.

i. *Extraneous variables* may be beyond the researcher‟s control such as respondents‟ honesty, personal biases and uncontrolled setting of the study.
ii. *Instrumentation:* The research instruments may not be standardized. Therefore a validity and reliability test will be done to produce a credible measurement of the research variables.
iii. *Testing:* The use of research assistants can bring about inconsistency in the administration of the questionnaires in terms of time of administration, understanding of the items in the questionnaires and explanations given to the respondents. To minimize this threat, the research assistants will be oriented and briefed on the procedures to be done in data collection.
iv. *Attrition*: Not all questionnaires maybe returned neither completely answered nor even retrieved back due to circumstances on the part of the respondents such as travels, sickness, hospitalization and refusal/withdrawal to participate. In anticipation to this, the researcher will reserve more respondents by exceeding the minimum sample size. The respondents will also be reminded not to leave any item in the questionnaires unanswered and will be closely followed up as to the date of retrieval.

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Appendix I: Sample Size Determination Table

Population size	Sample size	**Population size**	Sample size	**Population size**	Sample size
10	10	**220**	140	**1200**	291
15	14	**230**	144	**1300**	297
20	19	**240**	148	**1400**	302
25	24	**250**	152	**1500**	306
30	28	**260**	155	**1600**	310
35	32	**270**	159	**1700**	313
40	36	**280**	162	**1800**	317
45	40	**290**	165	**1900**	320
50	44	**300**	169	**2000**	322
55	48	**320**	175	**2200**	327
60	52	**340**	181	**2400**	331
65	56	**360**	186	**2600**	335
70	59	**380**	191	**2800**	338
75	63	**400**	196	**3000**	341
80	66	**420**	201	**3500**	346
85	70	**440**	205	**4000**	351
90	73	**460**	210	**4500**	354
95	76	**480**	214	**5000**	357
100	80	**500**	217	**6000**	361
110	86	**550**	226	**7000**	364
120	92	**600**	234	**8000**	367
130	97	**650**	242	**9000**	368
140	103	**700**	248	**10000**	370
150	108	**750**	254	**15000**	375
160	113	**800**	260	**20000**	377
170	118	**850**	265	**30000**	379
180	123	**900**	269	**40000**	380
190	127	**950**	274	**50000**	381
200	132	**1000**	278	**75000**	382
210	136	**1100**	280	**100000**	384

Source: Morgan and Krejcie (1970, cited by Amin 2005:454)

APPENDIX II -**TIME FRAME**

Activity							
2014	**Oct**	**Nov**	**Dec**				
Proposal submission							
Mobilizing and Reviewing existing data							
Data collection							
Data Entry							
Data Analysis and write up							
Supervisor (s) Review							
Submission of Dissertation							

Budget Proposal

Key activity	Amount(Ugshs)
Transport	2,000,000
Stationery	2,000,000
Accommodation	4,000,000
Feeding	12,000,000
Communication	2,000,000
Printing and binding	4,000,000
Data collection	6,000,000
Compilation	3,000,000
Contingencies	5,000,000
Total	**40,000,000**

Questionnaire to Finance Managers, accountants and / Cashiers of Selected SMEs

This study is an investigation of the impact ofInternational Financial Reporting Standards (IFRS) on performance of Small and Medium Enterprises (SMEs) in developing countries with specific reference to Uganda. You are selected to give viable information that will be analyzed to help policy makers and other authorities concerned with performance of SMEs, The information will be kept confidential. The questionnaire contains both open and close-ended questions in order to capture all necessary information.

- ✓ Tick the appropriate answer

Section A: Background Information

1. What is your level of education?

Certificate   Diploma   Degree   None

2. What accounting professional qualification do you hold?

CPA   ACCA   CIMA   Others Specify?-------------------------

3. How many people are employed in your SME? ---------------------------------

4. Rate the Level of Uptake of IFRS for SMEs using the following parameters.

	Very High	High	Low	Very Low	Unsure
Awareness					
Uptake					
Compliance					

5. Does your SME maintain Accounting Records?

Yes	No

6. What is the Nature of Accounting Records Maintained? Tick whatever is appropriate?

Source documents	Journal Ledgers	Ledger Accounts	Bank Reconciliation Statements	Cashbook (Receipts and Payments statement)

Section B: International Financial Reporting Variables

Indicate your level of agreement or disagreement with the following statements regarding International Financial Reporting Variables

4. My SMEs financial statements are prepared with Guidance from IFRSs and contain high quality information that is transparent for users and comparable over periods prescribed

Strongly disagree	**Disagree**	**Not sure**	**Agree**	**Strongly disagree**

5. My SMEs IFRS is transparent for users and comparable over periods prescribed

Strongly disagree	**Disagree**	**Not sure**	**Agree**	**Strongly disagree**

6. IFRS can be implemented at a cost that does not exceed the benefits to users

Strongly disagree	**Disagree**	**Not sure**	**Agree**	**Strongly disagree**

7. My SMEs prepares annual financial statements

Strongly disagree	**Disagree**	**Not sure**	**Agree**	**Strongly disagree**

8. My SME has a complete set of financial statements that comprises of a statement of financial position as at the end of the period;

Strongly disagree	**Disagree**	**Not sure**	**Agree**	**Strongly disagree**

9. My SME has a complete set of financial statements that comprises a statement of comprehensive income for the period;

Strongly disagree	**Disagree**	**Not sure**	**Agree**	**Strongly disagree**

10. My SME has a complete set of financial statements that comprises a statement of comprehensive income, statement of financial position and statement of changes in equity for the a particular period

Strongly disagree	**Disagree**	**Not sure**	**Agree**	**Strongly disagree**

11. My SME has a complete set of financial statements that comprises a statement of cash flows for the period;

Strongly disagree	**Disagree**	**Not sure**	**Agree**	**Strongly disagree**

12. My SME has a complete set of financial statements that comprises notes, comprising a summary of significant accounting policies and other explanatory information; and

Strongly disagree	**Disagree**	**Not sure**	**Agree**	**Strongly disagree**

Conformity of accounts with IFRSs

13. My SME has developed a set of accounting standards that improves the decision usefulness of financial reporting

Strongly disagree	Disagree	Not sure	Agree	Strongly disagree

14. My SMEs has reduced information irregularity

Strongly disagree	Disagree	Not sure	Agree	Strongly disagree

15. The accounting system of my SME results in favourable and positive economic consequences

Strongly disagree	Disagree	Not sure	Agree	Strongly disagree

16. My SMEs individual accounts have a legal relevance for taxation

Strongly disagree	Disagree	Not sure	Agree	Strongly disagree

Transparence of information for users

17. There is transparency and understandability of the information on business affairs of my SME

Strongly disagree	Disagree	Not sure	Agree	Strongly disagree

18. In my SME, I can easily value assets and liabilities with Guidance from IFRSs.

Strongly disagree	Disagree	Not sure	Agree	Strongly disagree

19. My SME can provide a possibility for objective disclosure of financial risks

Strongly disagree	Disagree	Not sure	Agree	Strongly disagree

20. My SME can easily make assessment of management decisions using available accounting reporting Reporting standards

Strongly disagree	Disagree	Not sure	Agree	Strongly disagree

Cost of financial management

21. Adoption of IFRS in my SME offers an edge over our competitors in the eyes of users

Strongly disagree	Disagree	Not sure	Agree	Strongly disagree

22. It is easy to access to Business funding because my SME is compliant with IFRS

Strongly disagree	Disagree	Not sure	Agree	Strongly disagree

23. My SME can trade its shares and securities on stock exchanges worldwide

Strongly disagree	Disagree	Not sure	Agree	Strongly disagree

24. Financial statements done with IFRs in Consideration can be presented fairly the financial position, financial performance and cash flows of my SME.

Strongly disagree	Disagree	Not sure	Agree	Strongly disagree

25. In my SME, we have faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses

Strongly disagree	**Disagree**	**Not sure**	**Agree**	**Strongly disagree**

26. The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation

Strongly disagree	**Disagree**	**Not sure**	**Agree**	**Strongly disagree**

Performance indicators

27. We pay our taxes regularly

Strongly disagree	**Disagree**	**Not sure**	**Agree**	**Strongly disagree**

28.Our Financial Reporting Standards and compliance to tax policies of SMEs in Uganda

Strongly disagree	**Disagree**	**Not sure**	**Agree**	**Strongly disagree**

29. I have increasing earnings of my SME

Strongly disagree	Disagree	Not sure	Agree	Strongly disagree

30. There is increased the market value of my shares

Strongly disagree	Disagree	Not sure	Agree	Strongly disagree

31. There is escalation the amount or frequency of the dividend paid

Strongly disagree	Disagree	Not sure	Agree	Strongly disagree

32. IFRS aid the Timeliness Production of financial reports of SMEs in Uganda

Strongly disagree	Disagree	Not sure	Agree	Strongly disagree