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Factors Affecting the Implementation of International Financial Reporting Standards for Small and Medium Enterprises in Kenya: A Case Study of Small and Medium Enterprises in Thika Town

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Abstract: **Small and Micro Enterprises (SMEs) play an important economic role in many countries. In Kenya, for example the SME sector contributed over 50% of new jobs created in 2005. Despite the big role SMEs play in the economy past statistics indicate that three out of five businesses fail within the first few months of operation (Kenya National Bureau of Statistics, 2007). Causes to the failure include limited market access, limited access to information, finances and technology and unfavorable policy and regulatory environment among others (ROK, 2005). The Council of the Institute of Certified Public Accountants of Kenya (ICPAK) and the Council of the National Board of Accountants and Auditors of Tanzania approved the use of IFRS for SMEs in 2009 yet majority of SMEs in Kenya have not implemented IFRS for SMEs. The study sought to carry out an investigation on the factors affecting the implementation of IFRS for SMEs in Kenya. Implementation of IFRS for SMEs is very crucial since SMEs contribute greatly to the economic development of a country. The research was carried out at Thika town Kenya since the town is an industrialized. A sample of 135 finance managers was done since they were directly and indirectly involved in the running of business of the firms. A questionnaire and interview guide were used to collect the data. A response rate of 89% was obtained. The study revealed that there is a positive relationship between the implementation of IFRS for SMEs and education and training skills of finance managers, availability of finance and awareness of IFRS for SMEs of magnitude0.217, 0.064 and 0.202 respectively. The positive relationship indicates that there is a correlation between the factors and the implementation of IFRS for SMEs in Kenya. This infers that education of finance managers has the highest effect on the implementation of IFRS for SMEs, followed by availability of finance and then awareness of IFRS for SMEs. The study found out that education and training affected the implementation of IFRS for SMEs and that majority of the respondents had not attended any form of training on accounting it therefore recommends that training policies should be introduced to the SMEs finance managers.**

Keywords: **implementation of IFRS for SMEs, Education of finance managers, availability of finance and awareness of IFRS for SMEs.**

1. INTRODUCTION

It is argued that if SMEs use the IFRS for SMEs then confidence in their reports would be enhanced (Bunea-Bontaset al., 2011). Adoption would lead to improved financial reporting, improved national comparability of business results, and improved access to capital (Hopeet al., 2006; Lunguetal., 2007; Mage, 2010). Access to capital is important as "the boundaries between economies and financial markets have been removed and mutual dependence has increased" (Alp and Ustundag, 2009). As barriers are reduced, a common understanding of financial accountability requirements is needed. Further, increasing accountability would enable SMEs to reach their potential as "growth engines" for their respective national economies. For developing economies which do not have well developed accounting standard-setting mechanisms, the IFRS for SMEs provides a ready-made set of standards

The adoption of IFRS for SMEs by SMEs in emerging economies is likely to have a positive impact on the accounting profession and reporting entities there. This is because such economies largely consist of small and medium sized entities. This development in financial reporting will in the near future improve the financial reporting in emerging economies and at the same time, result in more transparent reporting. However, the costs of adopting IFRS for SMEs, for instance, costs incurred in changing accounting information systems, hiring experts and training employees, may outweigh the benefits from compliance in some economies for years.

1.1 Statement of the problem:

According to the United Nations (2008) the concept of applying global reporting standards to SMEs in developing countries is believed to be more difficult than elsewhere

The Kenya financial reporting regulatory framework was complex, especially for small sized entities, representing the vast majority of the SME sector. The requirements of the IFRS for SMEs are still too complex for smaller entities with a simple business model Neaget al.(2009).

The complexity, structure, and interpretation of the principle-based standards (Alp and Ustundag, 2009) add to the implementation difficulties.

Any opportunity for reducing the reporting burden could represent a benefit to an important sector of the Kenya economy. The implementation of IFRS for SMEs is one potential route towards simplifications that was worth evaluating. The study therefore sought to carry out factors affecting the implementation of IFRS for SMEs in Kenya.

1.2 Objectives of the study

The general objective of this study was to identify the factors that affect the implementation of IFRS for SMEs in Kenya.

The specific objectives of the study were.

1. To evaluate how education of finance managers affects the implementation of IFRS for SMEs in Kenya.

2. To examine the extent to which availability of finance affects the implementation of IFRS for SMEs in Kenya.

3. To examine how awareness affects the implementation of IFRS for SMEs in Kenya

2. LITERATURE REVIEW

The chapter discussed the literature review of the study. The main aim of the literature review was to explore the available and existing information which had been covered by various researchers. The literature was reviewed from journals, the internet, reference books and reports.

2.1 Theoretical Frameworks:

2.1.1 Agency theory:

The agency conflict can be described as the Behaviour of managers who do not act in the best interests of the owners. The agency conflict may be reduced when the owner is involved in management (Fama & Jensen, 1983; Jensen & Meckling, 1976). Agency theory has been successfully applied to numerous disciplines including accounting, economics, politics, finance, marketing, and sociology.

With personal involvement in management, the owner could reduce the incentive for opportunistic behavior and ensure the manager will maximize the shareholder‘s wealth in its daily operation (Schultz, Lubatkin, Dino & Bucholtz, 2001). In contrast to listed entities, the sizes of SMEs are generally smaller and the owners are more likely to be involved in the business management. Carey (2008) suggests that the separation of ownership and management can cause agency conflict. With the owner‘s involvement, the incentive for opportunistic behaviour can therefore be reduced.

2.2 EMPIRICAL Review of variable:

2.2.1 Education of Finance Manager:

Many SMEs owners or managers lack managerial training and experience. The typical owner or managers of small businesses develop their own approach to management, through a process of trial and error (Anderson, 1993). As a result, their management style is likely to be more intuitive than analytical, more concerned with day-to-day operations than long-term issues, and more opportunistic than strategic in its concept. A consequence of poor managerial ability is that SME owners are ill prepared to face changes in the business environment and to plan appropriate changes in technology. Majority of those who run SMEs are ordinary lot whose educational background is lacking. Hence they may not well equip to carry out managerial routines for their enterprises (King and McGrath, 2002).

Research shows that majority of the lot carrying out micro and small enterprises in Kenya are not quite well equipped in terms of education and skills. Study suggests that those with more education and training are more likely to be successful in the SME sector (King and McGrath 2002). As such, for small businesses to do well in Kenya, people need to be well informed in terms of skills and management.

2.2.2 Availability of Finance:

These small entities often rube into trouble, not due to the poor quality of products, but due inadequate funding, they are unable to raise the funds from banks and other financial institutions, especially for their high risk project. Most financial institutions like banks are very conservative and risk averse and therefore avoid SMEs that are considered risky and with no collateral or dependable track records (Mughan, Lloyd, Reason Zimmerman 2004;Leah and Trucker, 2000; Luiz 2002).This keeps them out of competition, further weakening the support required for their operations and growth. The Kenya Industrial Estates requires that the SMEs should be in a registered association or group, to be able to access loans. However, most of the SMEs do not qualify to access the loans as they do not belong to any of the producer associations (Kirimi, 1988). Shortage of funds has been among the major constraints for the growth and development of small and medium enterprises (IASB Committee, 2009). Therefore, adoption of the IFRS for SMEs increases the ability of these organizations to obtain funds for their business.

2.3 Awareness of IFRS for SMEs:

Many businesses still don’t understand what options are available and how IFRS for SMEs interplay to their benefit (Fortuin, 2011). This is an indication of the lack of awareness of the benefits accrued through the use of IFRS for SMEs which may in turn inhibit SMEs from adopting them. The results of the survey by Deloitte in 2009 revealed that 43% of SME respondents were not aware of the IASB's standard IFRS for SMEs.

In this section, this study reviews some of the scholars’ prepositions on factors that support entities to comply with IFRS. For example, Wong (2006) argued that National professional accountancy bodies are required to create awareness and expand the knowledge of professional accountants and others on IFRS. He also added that educational institutions are encouraged to train trainers on IFRS requirements and offer programs of accounting and auditing that produce accounting graduates familiar with IFRS. For entities implementing IFRS, training programs should involve individuals at all levels of the entity and should continue after the initial transition to IFRS According to Bhattacharjee and Hossain (2010), a number of reasons were provided for the low level of adoption of IFRS for SMEs. In this regard, a number of explanations were brought forth which including unwillingness to work and accept a more principles-based set of accounting standards compared to the more rules-based IFRS (Adekoya,2011).

3. RESEARCH METHODOLOGY

The population for the study consists of total registered SMEs in Thika town. For this study 450 registered SMEs was the target population the target population comprises all kinds of SMEs in Thika town. Mugenda and Mugenda (2003) suggested that if objectively selected, a sample of between 10-30% of the population is considered adequate for generalization of the finding. Following the high level of homogeneity among the target respondents, this study used simple random sampling technique to select 30% of the respondents from each category. The study collected primary and secondary data. Primary data provided a presentation of the actual information that was obtained to accomplish the aim of the study. This primary data was gathered using both open ended and closed ended questionnaires. The questionnaires were self administered to the 120 finance managers who were picked for the purpose of analysis. Empirical and theoretical literature from books, journals and internet were sourced for the purpose of collecting the secondary data.

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Descriptive statistics in the form of frequencies, percentages and inferential statistics were used for analysis in the study (Mugenda and Mugenda (1999)). Statistical package for social science (spss) computer software (version 18) was used to present the data in the form of frequency, tables and percentages.

4. RESULTS AND THE STUDY

The study sought to establish the educational levels, the training, and the extent to which they affected the implementation of IFRS for SMEs.

From the findings, the study found out that 59% of the respondents had achieved secondary level as their highest level of education. 29% of the respondents had achieved College as their highest level of education while 12% of the respondent had achieved university as their highest level of education. These figures indicate high level of unqualified personnel in the implementation of IFRS for SMEs, which is contrary to the researcher Zeghal and Mhedhdbi, (2006) the adoption of IFRS requires a high level of education, competence, and expertise to be able to understand, interpret and then make use of these standards. Most of the respondents are not well educated implying that the firm is not capable of achieving its set goals through the human resources available. The results were shown in the figure below

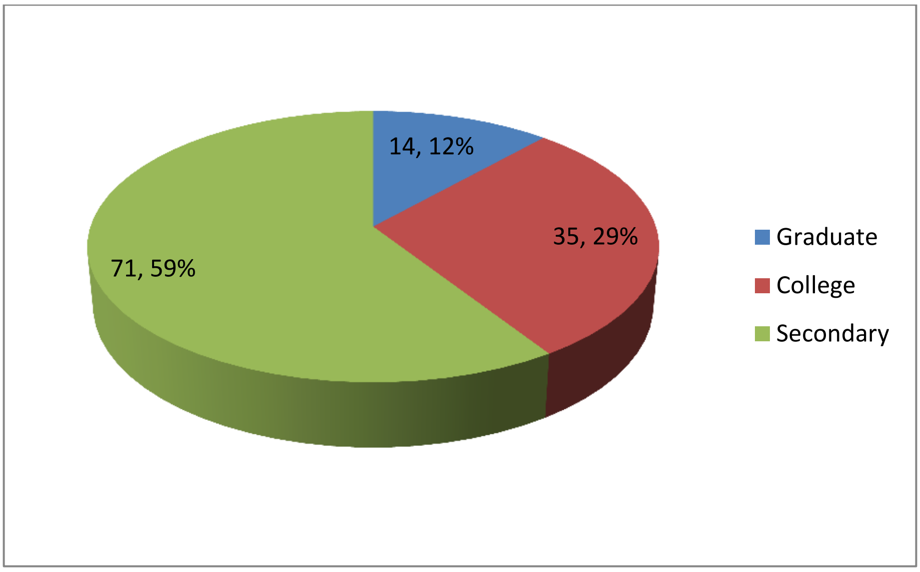

Figure 4.1: Managers' Qualification

4.1 Cross Tabulation between Education of Finance Managers and Implementation of IFRS for SMEs

The study sought to find out the relationship between education of finance managers and implementation of IFRS for SMEs. As indicated in Table 4.1 below, 60% implemented IFRS for SMEs were university graduate, 30% were from college and 18% were from secondary level. This implied that SMEs managed by graduate had implemented IFRS for SMEs as compared to others with low education. They develop their own approach to management, through a process of trial and error King and McGrath (2002) adds to this by arguing that majority of those who run SMEs are ordinary lot whose educational background is lacking hence may not well equip to carry out managerial routines for their enterprises. This could explain the reason as to why majority of the SMEs had not implemented IFRS for SMES.

Table 4.1: level of Implementation of IFRS for SMEs

Education	**Level of implementation**	
	Frequency	**Percentage**
Graduate	72	60
College	30	25
Secondary	18	15
Total	**120**	**100**

5. AVAILABILITY OF FINANCE

5.1 Source of Capital:

The researcher sought to establish the source of finance and the extent to which they influence the implementation of IFRS for SMEs as shown in table 5.1.

Table 5.1 Source of Capital

Source	Frequency	Percentage
Personal saving	70	58
Loan	20	17
From the family	30	25

From table 5.1, 70% of the respondents sourced their finance from personal saving. 17% from loan and 25% from the family. Majority of the SMEs get funds from personal saving which are not enough, SMEs require funds to meet needs at each stage of their life cycle, from creation through operation, development, expansion, and beyond. Many small businesses start out as an idea from one or two people, who invest their own money and probably turn to family and friends for financial help in return for a share in the business. But if they are successful, there comes a time for all developing SMEs when they need new investments to expand or innovate further. Access to funding and the high cost of finance through the traditional channels have been major constraints to SMEs hence the need to explore alternatives (Stella, 2011)

5.2 Cross Tabulation between Source of Finance and Implementation of IFRS for SMEs:

The researcher sought to establish how source of finance influence the implementation of IFRS for SMEs as shown in table 5.2.

Table 5.2: Source of Capital

Source	Level of Implementation	
	Frequency	Percentage
Personal saving	20	16
Loan	76	63
From the family	24	20

Table 5.2 shows that, 16% implemented IFRS for SMEs got their capital from personal saving, 63% acquired loan from banks and financial institutions and 20% got from their family. This implied that bank and other financial institutions require SMEs to have IFRS for them to qualify for the loan as compared to others sources of finance.

5.2.1 Finance Manager Awareness on IFRS for SMEs Requirements:

The researcher sought to find out extent to which finance managers are aware on IFRS for SMEs requirements and the response were as follows.

Table 5.3: Finance Manager Awareness on IFRS for SMEs requirements

Status	Frequency	Percentage
Aware of IFRS requirements	48	40
Not aware of IFRS requirements	72	60

From table 5.3, majority of the respondents are not aware of IFRS requirements at 60% while only 40% are aware on IFRS requirements. This implies that, since 2009 when Kenya approved the use of IFRS for SMEs, the awareness of IFRS for SMEs has not yet spread to most SMEs finance managers. Wong (2006) argued that National professional accountancy bodies are required to create awareness and expand the knowledge of professional accountants and others on IFRS. He also added that educational institutions are encouraged to train trainers on IFRS requirement and offer programs of accounting and auditing that produce accounting graduates familiar with IFRS. These findings are support the findings of Fortuin (2011), that many businesses still don't understand what options are available and how IFRS for SMEs interplay to their benefit. This is an indication of the lack of awareness of the benefits accrued through the use of IFRS for SMEs which may in turn inhibit SMEs from adopting them.

5.2.2 Factors Affecting the Implementation of IFRS for SMES:

The study computed the mean and the standard deviation to find out the extent to which the following factors have contributed to the implementation of IFRS for SMES in Kenya.

Table 5.4: Factors Affecting the Implementation of IFRS for SMEs

	Mean	Std. Deviation
Education of finance manager	3.119	1.722
Availability of finance	2.446	1.229
Awareness of IFRS for SMEs	2.228	1.191

From the study findings, it was established that education of finance manager contributed to the implementation of IFRS for SMEs to a moderate extent as shown by a mean of 3.119. Availability of finance was established to have contributed to the implementation of IFRS for SMEs of their business to a little extent as shown by a mean of 2.446 and finally on awareness of IFRS for SMEs it was established that it contributed to the implementation of IFRS for SMEs of their business to a little extent as shown by a mean of 2.228.

Inferential Statistics

Pearson's correlations analysis was then conducted at 95% confidence interval and 5% confidence level 2-tailed. The table above indicates the correlation matrix between the factors (education of finance manager, availability of finance and awareness of IFRS for SMEs) and the implementation of IFRS for SMEs. According to the table, there is a positive relationship between implementation of IFRS for SMEs and education of finance manager, availability of finance and awareness of IFRS for SMEs of magnitude 0.217, 0.064 and 0.202 respectively. The positive relationship indicates that there is a correlation between the factors and the implementation of IFRS for SMEs in Thika. This infers that education of finance manager has the highest effect on the implementation of IFRS for SMEs in Thika, followed by awareness of IFRS for SMEs and availability of finance.

6. CONCLUSIONS

From the findings the study concludes that education and training affected the implementation of IFRS for SME.This was specifically in terms of management skills inadequacy. Practical implementation of IFRS for SMEs requires adequate technical capacity among preparers and users of financial Statements. The finance managers who had received training and were well educated had implemented better than their colleagues who were not well educated. However, this was not uniform across board as implementation of IFRS for SMEs was a function of many factors some of which were beyond the scope of this study.

7. RECOMMENDATIONS

The study found out that education and training affected the implementation of IFRS for SMEs and that majority of the respondents had not attended any form of training on accounting or has done any professional courses on accounting it therefore recommends that training policies should be introduced to the SMEs finance managers. As county governments look at SMEs as a way of providing employment to the many unemployed youths, they should consider investing in these people by providing education and training.

The study also found out that an availability of finance affects the implementation of IFRS for SME; it therefore recommends that the stakeholders should provide funds to enable the implementation of IFRS for SMEs.

The study further found out that the awareness of IFRS for SMEs is very low and it affected the implementation of IFRS for SMEs, it is therefore recommends that the policy makers in Kenya need to organize workshops and create awareness on implementation of IFRS for SMEs. There is need for distribution of IFRS for SMEs in soft copies or hard copies to targeted SMEs, the roll-out of IFRS for SMEs training seminars by various professional bodies. The other recommendation is to add IFRS for SMEs to the curricular of colleges and Universities.

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