

## **IFRS IMPLEMENTATION IN SRI LANKAN UNIT TRUSTS: PERCEPTIONS OF STAKEHOLDERS INVOLVED IN THE IMPLEMENTATION PROCESS AND CHALLENGES FACED**

Ranasinghe A (*ajanee@gmail.com*)  
*Department of Accounting, University of Sri Jayewardenepura*

Senaratne S  
*Department of Accounting, University of Sri Jayewardenepura*

### **ABSTRACT**

At present, unit trusts in Sri Lanka are passing through a stage of rapid growth and are significantly affected by the convergence of local accounting standards with International Financial Reporting Standards (“IFRS Convergence”) brought to effect from January 2012. Hence, this study strives to address the research issues: how the stakeholders of Sri Lankan unit trusts who are directly involved in the preparation of financial reports perceive IFRS Convergence; and the challenges they face in implementing the changes owing to IFRS Convergence. In order to address this issue, the study aims to evaluate perceptions of stakeholders directly involved with preparation of financial reports of unit trusts on IFRS Convergence, and identify and analyse the challenges faced by Sri Lanka’s unit trusts in implementing changes arising from IFRS Convergence. The study is conducted in the form of a descriptive case study – which describes systems, techniques and procedures used in practice – covering the four stakeholder clusters that are directly involved in the implementation process of International Financial Reporting Standards in unit trusts; namely, Fund Management Companies (FMCs), Trustees, the Institute of Chartered Accountants of Sri Lanka (ICASL) and the Securities and Exchange Commission of Sri Lanka (SEC). When analysing the stakeholder perceptions, the strategic options evaluation model by Johnson *et al.* (2008) is used, where the strategy of IFRS Convergence is evaluated under the three headings; “suitability” to address key issues relating to the existing position and future direction of the industry/entity; “acceptability” to stakeholders and their expectations; and “feasibility” to execute using the resources and competencies the industry/entity possesses. The study uncovers that the Trustees and FMCs who are directly involved in preparing financial statements, perceive IFRS Convergence to be suitable and acceptable. However Trustees do not regard it feasible, whereas FMCs remain neutral. The ICASL perceives it to be suitable, acceptable and feasible for the unit trust industry, reflecting its role as the promulgator of financial reporting standards. Key implementation challenges faced by FMCs and Trustees are found to be process-related constraints; knowledge constraints; and time constraints. However, ICASL and SEC are not aware of these challenges, highlighting the poor communication between stakeholders.

**Keywords:** *Unit Trusts, IFRS, Perceptions, Challenges*

### **INTRODUCTION**

The convergence of local accounting standards with International Financial Reporting Standards (“IFRS Convergence”) marks a significant change in Sri Lanka’s financial reporting regulations. The parties that had to implement these changes are those stakeholders who were involved in the financial reporting process of entities affected by IFRS convergence. The United Nations Conference on Trade and Development [UNCTAD] (2008) highlights that the implementation of International Financial Reporting Standards (IFRS) requires considerable preparation both at the country and entity levels. It further elaborates the need for collaboration between regulatory institutions and entities preparing financial statements in

order to reap maximum benefits from IFRS Convergence. Past studies carried out on the perceptions of financial statement preparers on IFRS Convergence internationally (Morris *et al.*, 2014; Girbina *et al.*, 2012; Pawsey, 2010) further emphasize the importance of this stakeholder group in the IFRS implementation process. Hence, it is apparent that the reception of the changes by the stakeholders involved in the IFRS implementation process in Sri Lanka is important in obtaining optimal benefits of IFRS Convergence.

The Sri Lanka Accounting Standards converged with IFRS (SLFRS/LKAS), effective from January 2012, affected entities operating in different industries to varying degrees. Among these, a significantly affected segment is unit trusts in Sri Lanka (Ranasinghe, 2013), which had previously carried out the financial reporting function in accordance with the Recommended Accounting Practice for Open-Ended Unit Trusts (2000) issued by the Institute of Chartered Accountants of Sri Lanka (ICASL). Further, changes due to IFRS Convergence have been observed especially in the areas of fair value accounting (FVA), financial instruments presentation and measurement, and disclosures.

Unit trusts in Sri Lanka are passing through a stage of rapid growth and significance. The number of Fund Management Companies (FMCs) that manage the unit trust funds' investment activities has more than doubled in two years, leading to a total of thirteen FMCs by November 2013 from six in May 2011 (The Unit Trust Association [UTA] of Sri Lanka, 2013). The total assets held by unit trusts have also more than doubled from Rs. 22.7 billion in the end 2011 to Rs. 47.3 billion by the end of 2013. The government of Sri Lanka, identifying the importance of promoting unit trusts, offered concessionary income tax rates for FMCs in fiscal budgets for years 2013 and 2014. In addition, the Securities and Exchange Commission of Sri Lanka (SEC), as the regulator, formulated a ten-year master plan for developing the unit trust industry in 2006 and took various measures to conduct awareness campaigns on unit trust investments.

In light of the significant changes brought in by IFRS Convergence and the rising importance of the unit trust industry in Sri Lanka, this study explores the issues; *how the stakeholders of Sri Lankan unit trusts who are directly involved in the preparation of financial reports perceive IFRS Convergence; and the challenges they face in implementing changes owing to IFRS Convergence.* In order to address this issue, the study aims to evaluate perceptions of stakeholders directly involved with preparation of financial reports of unit trusts on IFRS Convergence, and identify and analyse the challenges faced by Sri Lanka's unit trusts in implementing changes arising from IFRS Convergence.

The contributions of this study are of several folds. As identified in the review of extant literature, this is the first study of its kind conducted on the Unit Trust industry in Sri Lanka. The findings of this study are expected to enrich the limited local literature on this area. Furthermore, they provide insight on the challenges faced in the IFRS implementation process in Unit Trusts, which will be important for policy setters in Sri Lanka to pitch future changes in financial reporting, such as the introduction of *SLFRS 9 - Financial Instruments* in January 2015, to Unit Trusts and similar industries effectively. These findings will also be used as a basis to explore whether similar perceptions and challenges apply to other industries as well.

The remainder of the paper is structured under four main headings: a literature review that discusses relevant prior studies; the methodology, which describes methods used to collect and analyse data; the data analysis and discussion, which analyses the perceptions on

IFRS Convergence and the implementation challenges; and the conclusion, which summarizes the findings and draws conclusions from them.

## **LITERATURE REVIEW**

This section discusses prior studies carried out, both internationally and locally, in relation to IFRS Convergence and/or adoption, the significance of IFRS Convergence in terms of impact to all entities in general, and the unit trust industry in particular.

The scores of studies carried out on IFRS Convergence and/or adoption, and its impacts on different industries emphasize its emerging importance in the global arena. As per Upton (2010), IFRS Convergence is a situation where jurisdictions decide to bring their national standards to a point where the amounts reported in the financial statements are the same as in IFRS financial statements. Many jurisdictions that have cultural, legal, or political obstacles to an immediate full adoption of IFRS opt for IFRS Convergence. However, he observes that convergence is not an objective in itself, but a means of achieving the ultimate objective of adoption of IFRS. According to the discussion with the Senior Manager – Technical at the ICASL on 11<sup>th</sup> July 2011, in Sri Lanka, IFRS Convergence is implemented, where the standards are applied to the country only after a due review process. Yet, it is further explained that great care is taken not to deviate from the international standards unless there is an absolute necessity, and only one out of the twenty nine standards initially converged with, had been slightly modified. Hence, it is apparent that even though Sri Lanka has implemented IFRS Convergence, it has adopted almost all standards without change. Therefore, for the purpose of this study, literature on both IFRS Convergence and adoption are reviewed in identifying the impacts created.

Iatridis and Rouvolis (2010) highlight the benefits of IFRS adoption in their study on post-adoption effects of IFRS implementation in Greece. As per the study, although the effects of IFRS in the first year of adoption appear to be unfavourable – perhaps due to the IFRS transition costs – firms' financial measures improved significantly in the subsequent period. The study provides evidence for the value addition to accounting with IFRS adoption. In contrast, Larson and Street (2004), Jermakowicz and Tomaszewski (2006), and Callao et al. (2007) discuss about issues faced by entities owing to IFRS Convergence and/or adoption in the international context.

Larson and Street (2004), in their study in Europe, identify the two most significant impediments to IFRS Convergence as the complicated nature of particular IFRS (including IFRS on financial instruments) and the tax-orientation of many national accounting systems. Other barriers include underdeveloped national capital markets, insufficient guidance on first-time application of IFRS, and limited experience with certain types of transactions such as pensions.

In a study based on the European Union, Jermakowicz and Tomaszewski (2006) found that the entities view the process of adopting IFRS as costly, complex, and burdensome. Further, it was found that companies expect increased volatility in financial results due to adoption of IFRS and face challenges not only due to the complexity of IFRS but also due to the lack of implementation guidance and uniform interpretation. It was also revealed through this study that a majority of respondents would not adopt IFRS if not required by regulations.

A study by Callao et al. (2007) in Spain has shown that local comparability is adversely affected if both IFRS and local accounting standards are applied in the same

country simultaneously. This could occur in the case where listed entities are required to follow standards converged with IFRS while unlisted entities are not required to do so. Therefore, the study highlights the urgency and importance of reforms to bring local rules in line with IFRS. It has also been found that there wasn't any improvement in the relevance of financial reporting to local stock market operators because the gap between book and market values is wider when IFRS are applied. While the study indicates no gain in terms of the usefulness of financial reporting in the short-term due to IFRS Convergence, the researchers opine that improved usefulness may be achieved in the medium to long-term.

It is evident from the above discussion that along with the benefits perceived by IFRS Convergence and/or adoption, entities will have to face various issues and overcome numerous challenges. The types and extent of issues faced in implementing IFRS may not be identical to all entities since they vary in terms of size, industry, nature of operations and many other factors. Internationally, it has been recognized that one of the most affected sectors will be financial institutions due to the FVA concept in IFRS. The vast number of studies carried out regarding the impact of FVA on financial institutions, especially such as those by Beatty *et al.* (1996), Barth *et al.* (1995), Chisnall (2001), and Allatt (2001) bear witness to this fact. Chisnall (2001), in particular, argues that securitization remains underdeveloped outside the United States of America and as a result, vast quantities of assets and liabilities would need to be estimated with little or no reference to market rates and significant assumptions would need to be made. This is said to create a noteworthy dent in the reliability of the financial information presented by financial institutions that deal with financial instruments.

In 2008, Deloitte Touche Tohmatsu Limited discussed challenges faced by investment funds, including unit trusts, when complying with IFRS. These challenges include accumulating data for disclosure requirements, consolidating certain investments with controlling interest, systems-related limitations and educating investors about the changes. These issues are said to impact technical accounting, process and statutory reporting, technology infrastructure *and* organizational attributes of investment funds. The outcome of these studies provides evidence that IFRS Convergence has a significant impact on all financial institutions in general and investment funds in particular.

The significance of financial statement preparers' involvement for successful IFRS Convergence has also been highlighted in past studies. Based on a series of case studies on IFRS implementation, UNCTAD (2008) highlights that the transition plan to IFRS and its implications for preparers, users, educators and other stakeholders have to be effectively coordinated and communicated in order to achieve a successful implementation. It further emphasizes that preparers, regulators and professional accountancy bodies need to be engaged in the planning of IFRS, as well as the implementation. Many instances have been revealed where lack of such coordination and communication has resulted in the failure to enjoy the full benefits of IFRS Convergence. Hence, it is evident that the stakeholders involved in the implementation process are key contributors to the successful implementation of IFRS.

Past studies on perceptions of preparers of financial statements on implementing IFRS further highlight the importance of this stakeholder group in the IFRS Convergence process. Morris *et al.* (2014) found that in Australia, financial statement preparers expressed concerns about the problems of IFRS implementation and the low level of expected benefits. They show that the primary sources of these concerns were the difficulties associated with specific accounting issues, the on-going monetary costs involved, and the perceived limited

capital market impact of the changes introduced. In another study on the Romanian banking industry Girbina *et al.* (2012) reveal that while most preparers still have a positive attitude towards the application of IFRS, they are highly concerned about the costs involved in the modification of systems and following specific accounting methodologies. An earlier study in Australia by Pawsey (2010) finds that preparers of financial statements, while acknowledging some benefits of IFRS adoption, had identified numerous faults in IFRS implementation in terms of complexity, time consumption, consultancy fees and confusion to users. These studies shed light on the perceptions of preparers of financial statements on IFRS implementation, which would be useful in the improvement of the overall value of IFRS Convergence as suggested by UNCTAD (2008).

In Sri Lanka, the FVA concept in IFRS has brought substantial changes to the financial reporting process of unit trusts and especially the new disclosure requirements and measurement of fixed income securities are seen to mark significant changes (Ranasinghe, 2013). There are several key stakeholders who are involved in the IFRS implementation process in unit trusts under different capacities. They are; the Trustees who are ultimately responsible for preparing financial statements for unit trusts; the FMCs who provide all the necessary information for Trustees; the SEC, who as the regulator is the authorizing body for financial statements; and the ICASL, who, being the promulgator of IFRS Convergence, plays a key role in providing guidance and support to the process.

Despite the contemporary importance of IFRS Convergence, the effect it is expected to have on Sri Lankan unit trusts, and the importance of stakeholders involved in the implementation process in achieving desired benefits, there exists a gap in literature on these stakeholders' views and issues on IFRS implementation. Hence, this study strives to explore how the stakeholders of Sri Lankan unit trusts who are directly involved with preparation of financial reports perceive IFRS Convergence; and the challenges they face in implementing changes owing to IFRS Convergence.

## **METHODOLOGY**

Conducted in the form of a descriptive case study, which describes systems, techniques and procedures used in practice (Scapens, 2004), the study is based on primary data gathered through a questionnaire, semi-structured interviews and observation, covering four stakeholder clusters of unit trusts, namely; FMCs who manage the funds; Trustees who safeguard the unit holders' interests; the ICASL which promulgates financial reporting standards in Sri Lanka; and the SEC which acts as the regulator to the unit trust industry. By November 2013 there were thirteen FMCs and three Trustees in the unit trust industry of Sri Lanka, all of whom, along with the ICASL and the SEC comprise the sampling frame of the case study. The entire sampling frame was approached in conducting the case study, although there were instances where certain institutions declined response, as detailed later.

Perceptions of stakeholders regarding the identified changes were gathered through a five-scale Likert questionnaire which covered the broad areas of "suitability (the strategy addresses key issues relating to the existing position and future direction of the organization), "acceptability" (the outcome of the strategy meets the expectations of the stakeholders) and "feasibility" (the organization possess the resources and competencies to deliver the strategy) with six statements under each criterion as shown in Table 2. The statements were initially developed with reference to the studies of Pawsey (2010) and Girbina *et al.* (2012). Next, expert opinions were obtained in this respect from the Alternate Chairman of the

Accounting Standards Committee in Sri Lanka and the President of the Unit Trust Association in Sri Lanka. The statements were refined to incorporate the comments of these experts. Accordingly, by following these procedures the validity of the questionnaire was improved. Finally, pilot testing was conducted with four fund accountants of FMCs and feedback was incorporated to improve the clarity as well as the reliability of statements, resulting in the final questionnaire.

A manager in charge of each of the three Trustees, the SEC, the ICASL and the fund accountants of the thirteen FMCs were requested to respond to the questionnaire. In administering the questionnaire, the researchers clarified each statement to the respondents in case of any uncertainty. For an example, in clarifying the first question, the researchers used their experience to identify drawbacks in financial reporting of Sri Lankan unit trusts prior to IFRS Convergence. Nine of the thirteen FMCs responded, resulting in a response rate of 69 percent, while the remaining four refused to participate in the survey. Two of the three Trustees responded, resulting in a response rate of 66 percent while one declined to participate. The ICASL also responded, whereas the SEC declined to respond to the questionnaire specifically, but provided a general perspective.

When analysing the stakeholder perceptions gathered through different sources, the Strategic Options Evaluation Model suggested by Johnson *et al.* (2008) was used. This model, widely advocated for use in the process of selecting strategies, provides three *success criteria* that assess the likely impact of strategic options. In this study, when considering the unit trust industry as whole, IFRS Convergence is a new financial reporting strategy with the objective of improving quality of information provision. Hence, the success criteria have been used to assess its success as perceived by different stakeholders. Accordingly, the strategy is evaluated under three headings; “suitability” to address key issues relating to the existing position and future direction of the entity; “acceptability” to stakeholders and their expectations; “feasibility” to deliver using the resources and competencies the entity possesses. The perceptions of each stakeholder group to the given statements and success criteria are assigned scores by averaging the responses to the Likert scale questionnaire. When analysing the perceptions of FMCs, to identify the differences from the neutral score of ‘3.00’, and between the three success criteria, parametric tests (i.e., One-sample *t*-test, One-way ANOVA and PostHoc tests) as well as non-parametric tests (i.e., Wilcoxon signed-rank test and Kruskal-Wallis test) were used. However, these tests were not used to analyse data for Trustees and the ICASL due to the small sample size. Hence, for them, simple average mean scores were used for analysis.

The implementation challenges faced by the unit trust industry were inquired from managers in charge of all three Trustees, and the relevant officials of the ICASL and the SEC. They provided their opinions on challenges faced through an interview of approximately 90 minutes each. Trustee C, who refused to participate in the survey on perceptions, agreed to respond to this interview. On the other hand, the fund accountants of FMCs provided a collective opinion to the researchers in the UTA meetings held specifically to discuss the challenges faced in the IFRS implementation process. One of the researchers was provided the opportunity to observe the three meetings of approximately 120 minutes each, conducted by the UTA on this matter.

The check-list for conducting the interview was developed initially with five possible categories of issues by referring to the works of Deloitte Touche Tohmatsu Limited (2008), Chisnall (2001), Larson and Street (2004) and Jermakowicz and Tomaszewski (2006),

UNCTAD (2008) explained in the literature review. Accordingly, knowledge constraints, time constraints, information constraints, financial constraints, negative investor reaction, and communication issues were initially identified as key issue categories (Refer Table 1 for details). Subsequently, based on expert comments provided by the Alternate Chairman of the Accounting Standards Committee in Sri Lanka, ‘process-related issues’ was added.

Table 1 Categories of challenges used for semi-structured interviews

Category	Description	Examples for challenges
Knowledge constraints	Insufficient knowledge to apply IFRS	Lack of awareness, lack of guidance mechanisms
Time constraints	Insufficient time to prepare for the convergence	Hurried implementation, insufficiency of time for preparation
Information constraints	Difficulties in obtaining information for financial reporting purposes	Issues in the information infrastructure of the market, difficulties in obtaining information as input to complying with IFRS
Financial constraints	High costs involved in the IFRS implementation process	Costs of consultancy, costs of changing process and systems
Negative investor reactions	Issues with dealing with customer requests and complaints on the changes	Potential customer complaints on changes
Communication issues	Poor communication between stakeholders involved in the IFRS implementation process	Lack of coordination, unawareness of other stakeholders’ challenges, delayed responses
Process-related issues	Challenges in making changes to the existing information systems and processes	Difficulties in adjusting existing information systems, difficulties in changing existing information flows

In analysing the challenges, the order of significance is ascertained from the opinions provided, which is compared across stakeholder groups. The opinions of the two trustees have been averaged, while those of the ICASL and the SEC are provided separately. With respect to FMCs, the fund accountants discussed the challenges in detail at UTA meetings and collectively provided an order of significance of the different challenges.

### **Data analysis and discussion**

This section details and analyses the perceptions of unit trusts’ stakeholders involved in the implementation process on IFRS Convergence and the challenges faced by them.

### **Perceptions of stakeholders**

Perceptions of the key stakeholder clusters of unit trusts that impact or are impacted by IFRS Convergence are first separately presented and thereafter a comparative analysis is carried out. The perception analysis is carried out based on the Strategic Options Evaluation Model by Johnson *et al.* (2008) as explained in the previous section.

## Perceptions of FMCs

The perceptions of the nine FMCs who responded to the questionnaire are summarized in Table 2. It provides the mean average scores and the statistical significance of the difference from the neutral value of 3, for each statement as well as the three criteria.

Table 2 Aggregate perceptions of FMCs

Criterion	Mean Score
Suitability	3.43*
Drawbacks of Financial reporting in Sri Lankan Unit Trusts (UTs) are addressed by IFRS Convergence.	3.78**
This is the correct time for introducing IFRS to Sri Lankan UTs.	3.33
The Sri Lankan UTs are ready to apply the changes required with IFRS Convergence.	3.78**
Not making special alterations to SLFRS/LKAS to suit Sri Lankan UTs was suitable.	2.89
IFRS provisions applicable to UTs in the global context are applicable to Sri Lankan UTs as well.	3.38
IFRS Convergence will support the growth of UTs	3.44
Acceptability	3.69**
Information provision in UTs' financial reports was below expectations in the past.	3.33
New standards provide a better base for investors to make decisions on.	4.11**
New standards provide fund managers greater incentive for better performance.	3.67*
Provisions in SLFRS/LKAS were convenient to apply for preparers of financial statements.	3.33
Benefits derived by users from new standards justify the costs they ultimately bear for compliance.	3.56*
IFRS Convergence supports the promotion of funds to non-resident investors.	4.11**
Feasibility	2.93
Financial sector infrastructure in Sri Lanka is sufficiently developed to provide the required input data.	3.22
Current systems and procedures are sufficient to gather required input data.	3.11
Competent resource persons are abundantly available for consultancy at reasonable cost.	2.78
There are mechanisms to get unclear areas of SLFRS/LKAS easily clarified.	3.00
Time period provided to apply changes was sufficient.	2.56*
There are no materially burdensome financial or other resource-related difficulties.	2.89

\*  $p < .05$ , \*\*  $p < .01$  based on One-sample t-test (further, the non-parametric version of the One-sample t-test, Wilcoxon Signed-rank test, produced qualitatively similar results).

Source: Author constructed

As shown in Table 2, The FMCs perceive IFRS Convergence as suitable, with a high score that is statistically significantly different ( $p < .05$ ) compared to the neutral value of "3". Within the criterion, a significantly strong agreement ( $p < .01$ ) is indicated for the statements on the 'readiness' of the unit trust industry to apply changes arising from IFRS Convergence and on the ability for IFRS Convergence to address the drawbacks of financial reporting in Sri Lankan unit trusts.

FMCs also seem to perceive IFRS Convergence as acceptable, with a strong significant agreement ( $p < .01$ ) compared to the neutral value of "3". Within the criterion, perceptions regarding the enhanced information value for investors through IFRS Convergence and the ability to promote unit trusts overseas have significantly ( $p < .01$ ) higher scores. The perception of FMCs on support for fund managers, and the net benefit over cost for users also have significantly ( $p < .05$ ) high scores.



With reference to feasibility, FMCs have generally maintained a neutral stance. However, a significantly ( $p < .05$ ) lower score is observable with respect to sufficiency of time to apply changes arising from IFRS Convergence.

Overall, the agreement of FMCs to the acceptability criterion showed a high statistically significant difference ( $p < .01$ ) with the neutral value of “3”. Furthermore, in terms of the suitability criterion, again a significant difference ( $p < .05$ ) was observed. However, FMCs were not significantly different from the neutral point, in their perception towards feasibility. Further, the non-parametric version of the One-sample t-test, Wilcoxon Signed-rank test, produced qualitatively similar results.

Table 3 Differences in perceptions of FMCs between criteria

Criterion 1	Criterion 2	Mean Difference
Suitability	Acceptability	-.25167
	Feasibility	.50667*
Acceptability	Suitability	.25167
	Feasibility	.75833**
Feasibility	Suitability	-.50667*
	Acceptability	-.75833**

\*  $p < .05$ , \*\*  $p < .01$  based on PostHoc tests

Source: Author constructed

When comparing among criteria, the One-way ANOVA indicates as a whole that there's a significant difference ( $p < .01$ ) among the criteria. A qualitatively similar result was observed under the non-parametric Kruskal-Wallis test. Furthermore, the PostHoc tests indicate significant differences between criteria as shown in Table 3. Accordingly, the FMCs' perception towards the feasibility criterion showed a statistically significant ( $p < .05$ ) lower value, when compared to their perceptions for the suitability and acceptability criteria. However, there is no significant difference ( $p > 0.05$ ) between their perceptions on suitability and acceptability.

In brief, FMCs, as the principal providers of information for financial reporting of unit trust have a positive perception towards suitability of IFRS Convergence in the present condition and future direction of unit trusts and also towards acceptability in terms of different stakeholder expectations. However, they maintain a neutral perception towards feasibility of applying the required changes.

### Perceptions of Trustees

The perceptions of Trustees on IFRS Convergence as the preparers of financial statements for unit trusts, are summarized in Table 4. The two Trustees that responded to the questionnaire are referred to as Trustee A and Trustee B.

Table 4: Analysis of perceptions of trustees

Criterion	Score		Mean Score
	Trustee A	Trustee B	
<b>Suitability</b>	3.67	3.50	3.58
Drawbacks of Financial reporting in Sri Lankan Unit Trusts (UTs) are addressed by IFRS Convergence.	4	3	3.50
This is the correct time for introducing IFRS to Sri Lankan UTs.	4	4	4.00
The Sri Lankan UTs are ready to apply the changes required with IFRS Convergence.	2	2	2.00
Not making special alterations to SLFRS/LKAS to suit Sri Lankan UTs was suitable.	4	4	4.00
IFRS provisions applicable to UTs in the global context are applicable to Sri Lankan UTs as well.	4	3	3.50
IFRS Convergence will support the growth of UTs	4	5	4.50
<b>Acceptability</b>	3.00	3.33	3.17
Information provision in UT financial reports was below expectations in the past.	3	4	3.50
New standards provide a better base for investors to make decisions on.	4	5	4.50
New standards provide fund managers greater incentive for better performance.	4	2	3.00
Provisions in SLFRS/LKAS were convenient to apply for preparers of financial statements.	1	1	1.00
Benefits derived by users from new standards justify the costs they ultimately bear for compliance.	2	3	2.50
IFRS Convergence supports the promotion of funds to non-resident investors.	4	5	4.50
<b>Feasibility</b>	2.17	1.67	1.92
Financial sector infrastructure in Sri Lanka is sufficiently developed to provide the required input data.	2	2	2.00
Current systems and procedures are sufficient to gather required input data.	3	2	2.50
Competent resource persons are abundantly available for consultancy at reasonable cost	2	2	2.00
There are mechanisms to get unclear areas of SLFRS/LKAS easily clarified.	2	1	1.50
Time period provided to apply changes was sufficient.	2	1	1.50
There are no materially burdensome financial or other resource-related difficulties.	2	2	2.00

*Source: Author constructed*

Overall, the Trustees perceive IFRS Convergence to be suitable to unit trusts and generally acceptable to stakeholders of unit trusts. This is evident by the average scores of 3.58 and 3.17 for suitability and acceptability respectively. However, Trustees have indicated disagreement about the feasibility for unit trusts to comply with provisions of SLFRS/LKAS with a low average score of 1.92.

Under suitability, the only item of disagreement from the Trustees is that the unit trust industry is ready to apply changes introduced by SLFRS/LKAS. But they agree that if complied, it will provide support for future growth. Trustees also agree that the timing of IFRS Convergence is appropriate despite the lack of readiness in the unit trust industry and there's no need to include special alterations to financial reporting standards to specifically suit unit trusts.

Trustees show mixed perceptions as to the acceptability of IFRS Convergence to different stakeholder groups' objectives. Both Trustees strongly disagree that the provisions in SLFRS/LKAS were convenient to apply for preparers of financial statements. This may be due to Trustees, being the financial statement preparers of unit trusts, experiencing first-hand difficulties, when complying with SLFRS/LKAS. In addition, Trustees perceive that IFRS Convergence will lead to more valuable information provision to investors and will also support the promotion of funds overseas. However, they perceive that the benefits investors derive would not be sufficient to warrant the heavy costs involved.

With reference to feasibility, both Trustees have indicated substantially low scores and the average scores display that they are unsatisfied with the country's financial infrastructure, existing information systems of FMCs, availability of consultants, mechanisms of getting issues clarified, time duration allowed and other resources.

Considering at an individual level Trustee A's and Trustee B's perceptions show striking similarities and both have scored all statements in a qualitatively similar manner. Only one conflicting view is observable where Trustee A perceives that IFRS Convergence will provide incentive for fund managers to perform better while Trustee B disagrees.

When comparing between criteria, the Trustees display a disagreement on feasibility criterion, which seems substantially different from their agreement to suitability and acceptability.

### **Perceptions of the ICASL and the SEC**

The ICASL, being the promulgator of financial reporting standards in Sri Lanka and the driving force behind IFRS Convergence, has provided strong agreement towards all three criteria. Accordingly, all three criteria have an average score of 4.17 each. When analysing further, it is observed that the ICASL has strongly agreed that IFRS Convergence supports industry growth, there's an ease of applying IFRS provisions for preparers and the time provided for compliance is sufficient. This positive perception by the ICASL is expected due to its role in initiating IFRS Convergence. The SEC, as the regulatory body for unit trusts declined to respond to the questionnaire, but provided a general perception that no material change will occur to unit trusts' financial reporting as a result of IFRS Convergence.

### **Comparison of perceptions between stakeholder clusters**

A summary of perceptions of different stakeholders of unit trusts is provided in Table 5.

Table 5 The summary of perceptions between stakeholder clusters

Criterion	Average Scores of Stakeholders		
	FMCs	Trustees	ICASL
Suitability	3.43	3.58	4.17
Acceptability	3.69	3.17	4.17
Feasibility	2.93	1.92	4.17

*Source: Author constructed*

When comparing the perceptions of the different stakeholders, while all agree on the suitability of IFRS Convergence, Trustees have a 0.15 higher average score than FMCs. The ICASL displays a stronger agreement with a 4.17 average score, which is 0.74 and 0.59 higher than FMCs and Trustees respectively.

All three stakeholders' perceptions on acceptability also indicate agreement, but with some differences in the extent. FMCs average score is 0.52 higher than that of Trustees. Again, the ICASL indicates a high score which is 0.48 and 1.0 above FMCs and Trustees respectively.

On the other hand, for feasibility, substantial differences in stakeholder perceptions can be observed. The FMCs are neutral with a 2.93 score while Trustees report a score that is 1.01 lower than FMCs indicating disagreement with the criterion. In comparison, the ICASL indicates a strong agreement to feasibility and report a score that is 1.24 and 2.25 higher than FMCs and Trustees respectively.

On the whole, the perceptions of the FMCs, Trustees and the ICASL seem to be moulded to a great extent by the role they play in the process of IFRS Convergence, as is visible in Figure 1, which provides a graphical representation of perceptions of the different stakeholder clusters.

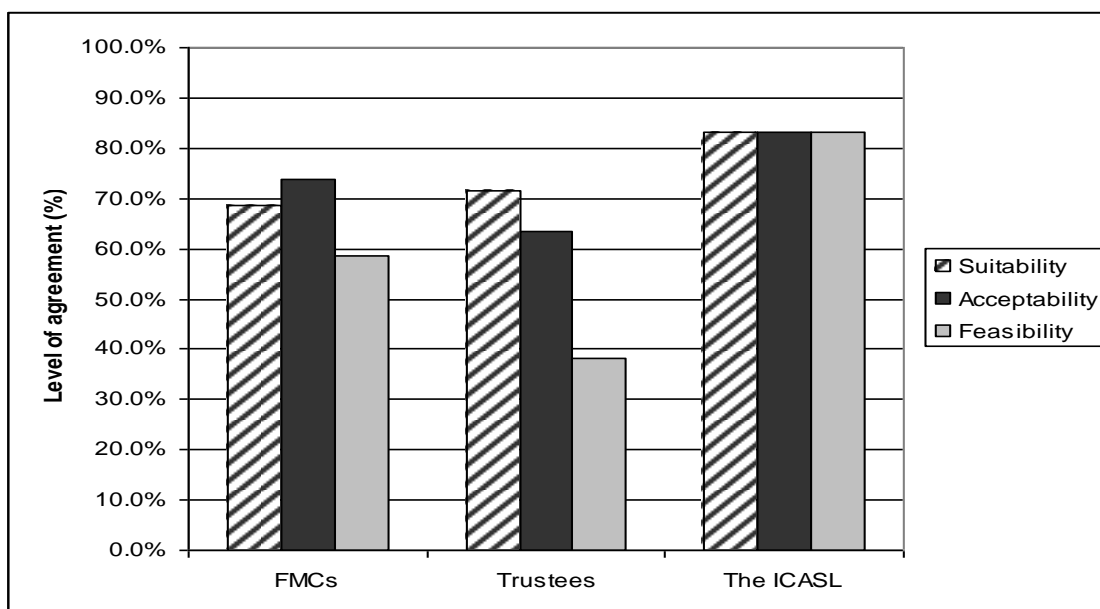


Figure 1 Perceptions of unit trusts' stakeholders on IFRS Convergence (Author constructed)

### Implementation challenges faced when complying with SLFRS/LKAS

This section firstly presents and analyses the challenges stipulated by each stakeholder cluster and then conducts a comparison to identify the similarities and differences of the challenges articulated by each of these clusters.

The challenges mentioned by interviewees are coded into seven broad categories as explained in the methodology section. These categories are knowledge constraints, time

constraints, information constraints, process-related constraints, financial constraints, perceived reactions of investors and other constraints.

### Challenges emphasized by Trustees

The summary of challenges articulated by Trustees, according to the order of significance as opined by each of them is provided in Table 6.

Table 6 The summary of challenges faced by Trustees in the order of significance

**Scale:** 1– Most significant; 2– Second most significant, 3– Third most significant; 4– Fourth most significant, 5– Fifth most significant; 6– Sixthmost significant; 7– Low in significance; 8– Not a constraint.

Challenge	Significance			
	Trustee A	Trustee B	Trustee C	Average
Process-related Constraints	2	1	8	3.7
Knowledge Constraints	1	8	2	3.7
Information Constraints	8	2	1	3.7
Poor Communication	3	8	8	6.3
Financial Constraints	8	3	8	6.3
Time Constraints	7	7	7	7.0
Negative Investor Reactions	8	8	8	8.0

*Source: Author constructed*

When comparing the challenges emphasized by the three Trustees, it can be observed that process-related constraints, knowledge constraints and information constraints are the three most significant issues highlighted.

Process-related constraints, which includes changes to be made to existing automated and manual information systems and processes of FMCs, are highlighted to be of highest significance by Trustee B while it's regarded second most significant by Trustee A. However Trustee C does not recognize the existence of process-related constraints.

Knowledge constraints, which includes lack of awareness of financial statement preparers and insufficient guidance mechanisms, are viewed as most significant by Trustee A while Trustee C views it as the second most significant. However, Trustee B does not consider this as a constraint.

Information constraints, including the availability of active markets and other information sources to perform required calculations, are regarded as most significant by Trustee C, and Trustee B considers it second most significant. Trustee A is of a different opinion and views that there are no information constraints since market prices are available for listed equity instruments and market interest rates are available for valuation of fixed-income securities. However, it can be observed that this opinion of Trustee A only evaluates the matter on the surface whereas the responses by Trustee B and Trustee C analyse the matter in more depth and recognise challenges in valuing instruments where available market rates are not representative of fair value such as when conditions for an active market are not met.

In addition, other issues such as poor communication and financial constraints due to changes required in the information systems were mentioned by some Trustees. But a difference in opinion regarding their significance is observed among the Trustees.

Overall, it can be concluded that knowledge constraints, process-related constraints and information constraints are regarded by Trustees as the most significant challenges faced by the unit trust industry due to IFRS Convergence. All three agree that there would have been no significant time constraints, had the FMCs prepared for the change beforehand. The Trustees also agree that investor reaction will be beneficial rather than constraining for unit trusts.

### **Challenges emphasized by FMCs**

As explained in the methodology section, the challenges emphasized by FMCs were gathered by observing the UTA meetings held specifically for Fund Accountants to discuss matters and challenges arising from IFRS Convergence.

The main challenge emphasized by all FMCs during UTA meetings was relating to process-related constraints. This included the inability of existing management information systems to segregate transaction costs from the fair value of financial assets with retrospective effect. In addition, the FMCs also expressed difficulties in performing risk analyses to meet disclosure requirements. In connection with this issue, the FMCs expressed time constraints faced in making improvements to existing information systems.

A second challenge expressed was the possible negative reaction by investors to certain implications of IFRS Convergence such as the volatility of unit prices of funds that invest solely in short-term fixed income securities. In the past, the unit prices of such funds followed a constant upward trend due to fixed income securities under a twelve-month maturity period being valued using amortised cost method rather than marking to market. Therefore, such funds were marketed as an alternative to regular savings accounts at banks and other financial institutions. However, subsequent to IFRS Convergence the unit prices of these funds will also fluctuate in the short term, which the FMCs feared, would trigger a negative reaction from existing and potential investors.

Apart from challenges voiced by the FMCs, it was observed by the researchers that the FMCs were uncertain on the disclosure requirements relating to financial instruments under *SLFRS 7*. Considerable time was utilized in each meeting to explain, discuss and understand various requirements. This indicates knowledge constraints on financial reporting under IFRS among FMCs.

Overall, it was observed that process-related constraints, time constraints and negative investor reactions were the three most significant challenges faced by FMCs in the IFRS implementation process. In addition, knowledge was also observed to be a substantial constrain by the researchers.

### **Challenges emphasized by the ICASL and the SEC**

By January 2013, the ICASL was not aware of any constraints faced by the unit trust industry when complying with *SLFRS/LKAS* and regarded that IFRS Convergence will be beneficial to unit trusts since it will improve the confidence of both local and international investor communities in unit trusts. The ICASL regards the level of financial reporting knowledge of the unit trust industry is of an acceptable standard and does not consider knowledge to be a constraint for them in IFRS Convergence. However, the representative from the ICASL explained that the unit trusts may be facing process-related constraints which

may also lead to time constraints, although no such constraint has been communicated to the ICASL by then. The SEC as the regulator of unit trusts expressed that it was not aware of any constraints faced by unit trusts due to IFRS Convergence.

### Comparison of challenges emphasized by stakeholder clusters

The challenges to unit trusts from IFRS Convergence highlighted by the four stakeholder clusters (i.e. Trustees, FMCs, the ICASL and the SEC) described above are compared in this section to identify similarities and differences and possible reasons for such similarities and differences. Table 7 summarizes the significance placed by each of the stakeholder clusters on the categories of challenges identified.

When conducting the comparison, it should be noted that the Trustees and FMCs experience challenges first hand, in their roles as financial statement preparers and information providers respectively. The ICASL and the SEC however are only informed of the challenges either by communicating with Trustees and FMCs or by other means such as observation of similar situations in other industries/jurisdictions.

Table 7 Challenges emphasized by stakeholders in the order of significance

**Scale:** 1– Most significant; 2– Second most significant, 3– Third most significant; 4– Fourth most significant, 5– Fifth most significant; 6– Sixth most significant; 7– Low in significance; 8– Not a constraint; ‘?’ – Not aware.

Challenge	Significance			
	Trustees	FMCs	The ICASL	The SEC
Knowledge Constraints	3.7	4	8	?
Process-related Constraints	3.7	1	?	?
Information Constraints	3.7	8	?	?
Poor Communication	6.3	8	?	?
Financial Constraints	6.3	8	?	?
Time Constraints	7.0	2	?	?
Negative Investor Reactions	8.0	3	8	8

*Source: Author constructed*

Process-related constraints have been emphasized by both Trustees and FMCs as a significant issue. The ICASL has commented on the possible existence of such constraints although it was not made aware by the UTA. The recognition of this issue by three of the stakeholder clusters implies its significance for unit trusts. However, under process-related constraints, the Trustees and the ICASL focused on disclosure requirements while the FMCs focused on segregation of transaction costs from fair value of financial assets. This can be because Trustees require the FMCs to provide the necessary information such as outstanding value of assets and liabilities. Therefore, the FMCs will be the party to experience process-related constraints when calculating fair values.

Time constraints connected to process-related constraints have been expressed by the FMCs while the ICASL suspects such an issue may exist although not made aware. Trustees have also expressed the existence of the issue, although it was attributed to the insufficient enthusiasm by FMCs to prepare for IFRS Convergence with time to spare.

Knowledge constraints of FMCs have been highlighted as significant by the Trustees while possible indications of the same were observed in the UTA meetings related to IFRS

Convergence. The ICASL has provided an opposing view and has regarded there were no such constraints visible in the unit trust industry.

Information constraints have been highlighted by the Trustees, but not so much by the FMCs, the SEC or the ICASL. However, the FMCs agreeing to the sufficiency of information availability implies that the issue is in fact not significant to unit trusts. The Trustees' deviant perspective stem from concerns about the blind use of market price as a proxy for fair value, even where pre-conditions for an active market are not met. Therefore, the Trustees have identified a fundamental flaw in applying principles of SLFRS/LKAS rather than an actual implementation challenge for unit trusts.

Negative investor reaction has been highlighted by the FMCs as a challenge, which is due to the practical issues they have to face when marketing funds comprising of short-term fixed income securities. However, the ICASL categorically refuses this to be a challenge, since conceptually; fair value would provide better information to investors. The Trustees, who are not involved in the marketing of funds and are responsible for protecting the interest of unit holders, understandably, agrees with the ICASL that the investors will react positively to financial reporting under SLFRS/LKAS,.

Poor communication, as highlighted as significant by one of the Trustees can be observed as an underlying issue that amplifies the severity of other challenges. The unawareness of ICASL and SEC of the challenges faced by unit trusts implies that the UTA, the SEC and the ICASL have not sufficiently communicated with each other regarding the challenges faced. In addition, the existence of some disparities between SLFRS/LKAS and previously issued directives by the SEC imply that communication gaps have existed between the SEC and the ICASL as well. The FMCs also lacked awareness about support services provided by the ICASL on IFRS Convergence. All such issues provide evidence for poor communication between stakeholders in the IFRS implementation process of unit trusts.

Financial constraints, although emphasized by one of the Trustees, were not considered as a material challenge by other stakeholders.

Overall, it can be observed that process-related and knowledge constraints are considered the most significant by FMCs and Trustees whilst certain other constraints such as time constraints are resultant challenges. They have mixed perspectives regarding investor reactions and information constraints. Poor communication is observed to be an underlying issue that amplify the severity of other challenges, as observed by the divergent opinions among the ICASL, the SEC, and the Trustees and FMCs.

## **CONCLUSION**

This study focused on the implications of IFRS Convergence to Unit Trusts in Sri Lanka as perceived by the stakeholders directly involved with preparation of financial reports. In this respect the objectives of the study were to; evaluate perceptions of these stakeholders on IFRS Convergence; and identify and analyse the challenges faced by Sri Lanka's unit trusts in implementing changes owing to IFRS Convergence.

In relation to the evaluation of perceptions of stakeholders of unit trusts on IFRS Convergence, it was found that FMCs perceive IFRS Convergence to be acceptable and suitable with a statistically significant difference from the neutral point of 3. However, they had a neutral perception principally on the feasibility because of limitations in resources,



competencies and time. In addition, Trustees perceive IFRS Convergence to be suitable and acceptable but harbour a strong disagreement about the feasibility due to the poor status of the country's financial infrastructure, limitations in the existing systems of FMCs, insufficient consultancy and mechanisms for clarifying issues, and limitations in time and other resources. The ICASL maintains a highly positive perception towards the suitability, acceptability and feasibility of IFRS Convergence and the SEC perceives that no material change will occur to unit trusts' financial reporting as a result of IFRS Convergence.

From the above findings it can be concluded that the perceptions of stakeholders of unit trusts regarding IFRS Convergence are moulded to a greater extent by the role they play in the process of IFRS Convergence. The Trustees, being the ones to experience implementation challenges first hand, express concern on the feasibility of complying with SLFRS/LKAS. The strong positive perception by the ICASL in relation to all three aspects – suitability, acceptability and feasibility – can be appropriated to its role in promoting IFRS Convergence.

When compared to existing literature, the findings are qualitatively similar to the study by Girbina *et al.* (2012), where financial statement preparers of the Romanian banking industry displayed positive attitude towards IFRS but were highly concerned with the costs involved in modification of systems. Similar results have been observed by Pawsey (2010) where financial statement preparers from various industries in Australia, while acknowledging some benefits of IFRS adoption, had identified numerous faults in IFRS implementation in terms of complexity, time consumption, consultancy fees and confusion to users. Hence, the perceptions of stakeholders directly involved in financial statement preparation of Sri Lankan unit trusts (i.e. Trustees and FMCs) seem to display similar perceptions to other financial statement preparers internationally.

In relation to the analysis of challenges, the main implementation challenges identified by the stakeholders were process-related constraints, knowledge constraints, and to a certain extent, time constraints. Communication issues between the stakeholders were also observed by the researchers to be an underlying issue that augmented other challenges. These IFRS implementation challenges can, to a certain extent, explain the reservations regarding the feasibility of IFRS Convergence by Trustees.

The findings on challenges agree with Deloitte Touche Tohmatsu Limited (2008) that incompatibilities of existing systems (i.e. process-related constraints) pose a significant challenge for investment funds from IFRS Convergence, but disagrees that the accumulation of data and investor education are significant. It also agrees that insufficient guidance on first-time application of IFRS and complexity of IFRS were challenges (i.e. knowledge constraints), similar to Jermakowicz and Tomaszewski (2006), Morris *et al.* (2014), and Larson and Street (2004). However, the findings do not agree with Chisnall (2001), and Larson and Street (2004) that underdeveloped capital markets leading to poor information sources (i.e. information constraints) are key challenges faced by financial statement preparers in Sri Lankan unit trusts. The importance of communication and coordination between stakeholders in the IFRS implementation process as highlighted by UNCTAD (2008) too seems to prevail in Sri Lankan unit trusts where poor communication between stakeholders is observed as an underlying challenge.

Despite the many similarities in findings to the global context, the study suffers from an inherent limitation of being an analysis of a change at its point of implementation. Hence, the long-term consequences may not have been visible in the short run. In addition, the study

is focused on a selected industry in a developing country, with a limited sampling frame. These limitations open up avenues for future studies; such as, to verify the findings several years after IFRS Convergence; and to expand the scope to other industries which are significantly affected from IFRS Convergence. In addition, the reasons for the stakeholder perceptions and challenges can be examined further and the strategies adopted by the unit trust industry to face the identified challenges and solve the problems can be explored in future studies.

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