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Issues in adopting IFRS (International Financial Reporting Standards) for small and medium-sized entities

Rufat Agabalayev

Supervisor: Abdulkarim Sadhigov

UNEC SABAH

Azerbaijan State Economic University

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Abstract

The rapid development of the world economies and increasing trend for cross-border transactions following the end World War II has increased the demand for uniformly accepted set of accounting standards that would facilitate the flow of accounting information and understandability and comparability of accounting information across borders.

In such environment, International Financial Reporting Standard has been developed by International Accounting Standards Board. Despite its wide acceptance, majority of business professionals and academic scholars acknowledged the fact that IFRS is designed for large and multinational companies and not necessarily meet the needs of Small and Medium-sized entities.

However, following the increased focus on SMEs in the European Countries and the fear of IASB that local regulators will develop their own standards IASB issued its own modified IFRS for SMEs. While the newly issued standard was designed to improve the existing absence of unified regulations for SMEs, it brought more questions than answers. In that case, the question arise whether IFRS for SMEs should be accepted and implemented by SMEs considering the cost/benefit analysis of adopting the new standard.

In this research I analyze the practicability of applying IFRS for SMEs in the Republic of Azerbaijan. First I perform deep literature review analysis considering the pros and cons of adopting the IFRS standards. The literature review reveals that SMEs with turnover of less 1 million adopting IFRS for SMEs incur additional costs of burden reporting without obtaining benefit of reporting under IFRS.

Additionally, I analyze the benefit of reporting under IFRS in European countries from perspective of ease of obtaining external financing. The results revealed that reporting under IFRS for SMEs do not results in easy access to external financing.

And finally, I performed interviews with business professional from audit firms and the industry to obtain their view on applying IFRS in their companies. The results

of interviews revealed that application of IFRS will not necessarily result in additional benefits for the large companies. And all interviewees agreed that for small companies there will be no benefits at all.

Abbreviations

SME – Small and Medium-sized Entities

IFRS – International Financial Reporting Standard

IAS – International Accounting Standards

IFRIC – International Financial Reporting Interpretations Committee

IASB – International Accounting Standards Board

US GAAP – United States Generally Accepted Accounting Principles

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Introduction

Background to the Research

Rapidly changing world economic patterns following the end of the Second World War have shaped the economies of many countries and impacted the way businesses are run. Starting since 1990s, the economic growth and tendency towards globalization of the world economy have reached new heights.

Similar to the English language, as communication and business language worldwide, has played an important role in globalization, International Financial Reporting Standards developed by International Accounting Standards Board has facilitated the exchange of accounting information.

International Financial Reporting Standards and International Accounting Standards have been developed with the main purpose of simplifying the exchange of accounting information between various corporations worldwide. Initially, the accounting standards were developed by International Accounting Standards Committee (IASC) and carried abbreviation of IAS (International Accounting Standards). The first issued IAS dates back to 1971.

However, since April 1st 2001, International Accounting Standards Board took over (IASC) and standards were renamed to IFRS. Due to its application in a world economy, IFRS as a financial accounting standard has gained wide acceptance. List of countries, including European Countries have fully adopted the IFRS as an accounting framework. Despite the wide popularity and application of IFRS, it should be noted that IFRS and IAS have been primarily developed for large and publicly listed companies (Evans, et al., 2005). While in IFRS and IAS can be considered suitable for small and medium-sized entities, IASB understood the different user needs and cost considerations.

In the absence of proper regulations for accounting and financial reporting for Small and Medium-sized Enterprises, local regulations concerning SME started taking over. IASB, concerned by the fact that other regulators working on a set of standard for SME may not use Conceptual Framework of IASB, decided to focus on accounting and reporting requirements of SME and issue IFRS for SME. As such, in 2003 the International Accounting Standards Board voted to extend the coverage of IFRS to SME (Pacter, 2004).

In June 2004, the International Accounting Standard Board issued the Discussion Paper regarding the "Preliminary views on Accounting Standards for Small and Medium-sized Entities" (Di Pietra, et al., 2007). Even though IFRS for Small and Medium-sized Entities was expected to bring clarity to accounting and reporting framework for SME, the results dubious. Following the publication of draft exposure of IFRS for SMEs significant deficiencies were pointed out in the standard. Among those deficiencies most significant are related to cost and benefit analysis of reporting under IFRS for SMEs, local accounting regulations which provide different reporting and accounting requirements for SMEs, bias of IFRS towards large and public entities, etc. (Di Pietra, et al., 2007). Based on stipulated questions and problems relating to the issuance of IFRS for SMEs I pose the research question as follows:

Does indeed IFRS for Small and Medium-based Entities offer accounting and reporting alternative for SMEs?

The research will be based on a mix of quantitative and qualitative analysis. From the qualitative perspective, I will analyse the implications of adopting IFRS for SMEs and cost and benefit approach for those companies adopting IFRS for SMEs. From quantitative perspective I will analyse the cost and benefits of IFRS for SMEs in Western European countries by utilizing the regression analysis. The objectives of research paper is to:

- Understand the Conceptual Framework utilized by IASB in developing IFRS and IAS
- Understand of conceptual framework of IFRS for SMEs
- Understand the requirements of IFRS for SMEs

- Analyse the critique of IFRS for SMEs
- Understand the need of IFRS for SMEs
- Cost and Benefit of adopting IFRS for SMEs

Importance of the Research

This research is of higher importance for those countries where Small and Medium-based entities constitute significant portion of the economy. Particularly in Azerbaijan, the Presidential decrees of President of Republic of Azerbaijan are directed towards the development and establishment of SME sector. Therefore, it is important to understand benefits that can IFRS for SMEs bring.

Literature Review

Development of International Financial Reporting Standard and Its Objectives

IASB (International Accounting Standards Board) issues the IFRS (International Financial Reporting Standards) to create financial reporting practice that is comprehensible, comparable and understandable throughout international boundaries. The standards that published by IASB are based on Conceptual Framework developed.

The Conceptual Framework is formed based on qualitative characteristics and accounting concepts. The qualitative characteristics include:

- **Relevance.** Relevance concept is based on the notion that only relevant information is useful for the wide range of financial statement users. It is, therefore, considered that only relevant information is capable of affecting decision-making process and only relevant information has predictive and/or confirmatory value.
- **Faithful representation.** Financial reports under IFRS should be truly represented without including any bias. The Conceptual Framework goes further in defining characteristics of Faithful Representation. To be faithfully representative the information should be free from error, neutral, and complete. A complete characteristic indicates that all information for users of financial statements to understand the economic phenomena and can make rational decisions ought to be included in the financial statements. A neutral characteristics indicates that information should not be manipulated in order to affect the decision making process of financial statement users. A free from error characteristic indicates that there are no any omissions or errors in financial statement that may influence the decision making process of financial statement users.
- **Comparability.** Conceptual Framework defines Comparability as "the qualitative characteristics which allows users to recognize and comprehend

similarities in, and dissimilarities among, items. The information regarding to a reporting firm is more helpful if it could be contrasted with comparable information regarding to other firms and with comparable data about the exact same firm for a further date, stage or period". By pursuing the characteristic of comparability, the Conceptual Framework enables users of financial statements to compare the actual performance of the company to prior years or to peer companies.

- **Verifiability.** Verifiability is defined as "Verifiability assists to assure customers that the information is faithfully representing economic phenomena that it purports to constitute. It means various independent and knowledgeable commentators can reach an agreement that the specific representation is the faithful representation".
- **Timeliness.** Timeliness characteristic indicates that information provided to financial statement users is timely and not outdated so that the users can make decisions using the information provided.
- **Understandability.** Accounting to the Conceptual Framework "classifying, characterizing, and presentation of information briefly and clearly makes this information comprehensible". Financial statement is prepared with the purpose of presenting information to financial statement users. Therefore, understandability of financial statements imply that it is prepared for users with adequate and sensible knowledge of the economic and business actions. Some information, which is presented in financial statements, are inherently complex and therefore require higher skills, while some are easy and therefore understandable by various set of financial statement users. As such, Conceptual Framework says, no information should be omitted from the financial statements solely based on their difficulty.

Accounting concepts include the following concepts:

- **Materiality.** According to the Conceptual Framework "Information is considered as material if its misstating or omitting can affect users' decisions which they make based on the financial information according to the specific reporting firm".
- **Substance over form.** Substance over form concept indicates that economic nature of transaction should be considered rather than its legal form. This concept is closely related to the fair presentation concept.
- **Going concern.** Going concern concept assumes that the entity will continue its operation within at least next 12 months period. Therefore, the going concern concept implies that preparation of the financial statements should not include assets at their break-up values (liquidation value).
- **Business entity concept.** Business entity concept implies that business is a separate entity and therefore transactions of the owner or shareholder should be separated from the business operations.
- **Accruals.** Accrual basis indicates that transactions are recorded and considered when they occur, not when the receipt and/or disbursement of cash is made.
- **Fair presentation.** Fair presentation concept requires the financial statements to give a "fair presentation or present fairly in all material respects". Nevertheless, in some circumstance the IFRS allows the management to depart from IFRS, when such departure is required in order to achieve fair presentation.
- **Consistency.** Consistency concept states that "classification and presentation of the items in financial statement ought to stay the same from a period to the following" except few situations. These situations include:
    a. Change in nature of activity
    b. A change in presentation in alignment with IFRS

Medium-sized and Small Companies and Financial Reporting

The Medium-sized and Small firms have enormous significance for the economy of developed countries. As an illustration, in the United Kingdom, in 90's SMEs constituted approximately 80 percent of firms registering accounts and about 50 percent of the non-government employment (Dugdale, 1998). In total 99 percent of the companies in the United Kingdom are small firms (Collis & Jarvis, 2000).

In Germany, for example, there is conventionally even more serious and influential SME sector compared to the UK. Additionally in other European countries, in Spain and Italy, in 1990, SMEs constituted 99 percent of whole number of business firms, and constituted 82 and 92 percent, respectively, of employment (Paolini, 1999). Large-scale privatization in Poland implemented by the government increased rapidly progress of SME sector. Currently SMEs sector represents 99 percent of active companies and exploits more than 60 percent of the work force (Jaruga & Fijalkowska, 2004).

In contrast to the United States of America, in European Union a large number of Medium-sized and Small firms are explained by the presence of company law (Bollen, 1996). The company law practice in the European countries duly relieves Medium-sized and Small firms from various compliance costs, audit, etc. However, despite the fact that 99 percent of companies in the United Kingdom are medium-sized and small companies, they experience the burden of higher corporate costs in comparison to their European counterparts. The similar issue also exists in the United States of America, where the burden of compliance costs for SMEs are very high. In such situation as stated by the Evans et al. (2005) *"the question appears as if a regulatory framework established initially for companies reporting within in a period the Anglo-American governance and the capital market context, as that established via the IASB, could usefully be adjusted to the requirements of SMEs in the EU representative states"*.

This question mainly indicates that whether the International Financial Reporting Standards developed by International Accounting Standards Board for predominantly companies operating under Anglo-American legislation (high compliance costs for all firms) can be suited to European entities.

Evans et al. (2005) further argues that “The essential dispute for differential reporting (made mainly in national frameworks) are the excessive burdens and inordinate reporting costs carried by much smaller businesses”. Additional arguments include (Collis et al., 2001):

- “narrower user groups”
- “convenience for a limited range of judgment”
- “less complicated transactions”
- “less requirement for complex analysis of highly collective information”

Based on the above mentioned arguments it is clear to understand that Medium-sized and Small firms in order to report under IFRS must incur significant costs. Then the question arise whether the benefits from reporting under IFRS would offset the costs incurred to prepare financial statements under IFRS. From business rationality, perspective companies the global attractiveness and acceptability of IFRS was facilitated and expedited due to rapid globalization trends across the various continents, which made the transformation and exchange of accounting information as crucial necessity.

Additional arguments relate to the narrow user groups of financial statements of SMEs and usefulness of financial statements for a narrower range of decision makers. Indeed, the SMEs are of lesser interest to international large corporations, as well as for various institutional investors. The financial statements of SMEs are of primary interest to the banks and various loan facility

The essential controversy against distinctive reporting is the necessity for universally acceptable set of standards (Evans, et al., 2005). Companies reporting under various accounting framework will have different treatments regarding the same issue, therefore the fair presentation characteristics of financial statements will be violated. Nevertheless, the results of analysis by IASB have revealed that many countries have their own legislation regarding reporting for Medium-sized and Small firms (Pacter, 2004).

Other arguments regarding the universally acceptable set of standards based on the necessity for the public interest, comparability, reliability, the publicity doctrine, the anxiety of making smaller firms “second class citizens”, etc. (Collis e. a., 2001).

The earlier studies performed in the United Kingdom suggest that management of Medium-sized and Small firms did not view the compliance costs as unduly burden. According to Carsberg et al. (1985) the unwillingness to report under unified set of standards was caused by lack of awareness and other associated costs like privacy loss, etc. Harvey and Walton (1996) also supported this finding.

According to Collis and Jarvis (2000) “the essential financial reporting advantages perceived by UK SME owner managers were affirmation and proof of results, while the essential drawback was cost (financial, monetary and time/awkwardness)”. The result of the survey performed by Collis and Jarvis did not reveal fear from participants for loss privacy and so on.

However, it should be mentioned that in assessing the cost and benefit analysis the size of the company has played significant role. Generally, the companies with annual turnover of more than 1 million GBP perceived the benefits of reporting under unified set of standards, while companies with annual turnover of less than 1 million GBP perceived the disadvantages of reporting under unified set of standards.

John and Healeas (2000) have analyzed the relevance of United Kingdom’s Financial Reporting Standards for Smaller Entities or Firms (FRSSE). They found that small companies may be unwilling to adopt the standards due to intention or likelihood of their potential growth.

Financial Statements Users and Their Needs

Small and Medium-sized companies have been attracting significant amount of interest in the global arena for accounting (Perera & Chand, 2015). While many countries adopted and/or considered IFRS to be suitable for publicly listed and large multinational companies, those countries were reluctant to adopt this set of standards towards SMEs.

Following the rapid development of the world economies and the increasing role of the Small and Medium-sized entities in the economic activity, IASB decided to issue new standard that will be applicable to SMEs, since the previous standard was related to the large and multinational companies.

In order to develop the reporting standards for Medium and Small-sized firms it is very necessary to determine the user groups and user needs of those financial statements. According to Evans et al. (2005) "The essential user group of SME financial statements determined by the literature are "providers of loan finance, managers, employees, Tax Department and trade creditors". The survey of by Paoloni and Demartini (1997) in Italy revealed that the main groups are: (i) Banks (constituting the interest of public) and Tax authorities and (ii) management.

Therefore it is often argued that the needs of users of the Medium and Small-sized firms are differ from the user needs to large and multinational companies. If we look at it from the perspective of the large multinational company, people interest in the financial statements of large multinational company are shareholder, banks, financial institutions, tax authorities, the regulatory agencies, the government, employees, and other various public stakeholders. This is explained by the fact that due to its large size and importance to the national economy in terms of employment and overall economic stability, the action of the large multinational companies are constantly overviewed. Additionally, large multinational companies in the search for additional capital refer to the various financial institutions, security market, and foreign security market. Therefore, wrong-doings of large multinational companies are always covered by various newspapers and magazines.

In contrast to large multinational companies Medium and Small-sized companies do not receive such large attention. Medium and Small-sized firms are of higher importance to the tax authorities and the management of the company (which is usually shareholder himself).

Vehmanen and Riistama (2004) discuss that the requirements of users of SME accounts differentiate from user needs of multinational companies. As instance, the firm values at any moment in time is less appropriate than their capability to create positive cash flow, and their liquidity and profitability. According to ICAS (1998), SME accounts users require assurance on solvency, profitability, events of earlier year, future possibilities, and quality of the management. Venture capitalist investors in SMEs, however, have wider information requirements than are satisfied by the external financial reporting conventions – the additional information ought to be made by firms (Paoloni et al., 2003).

There are separate findings on the effectiveness of the statutory financial statements to main users (especially in management) of the SME accounts. Dugdale and others. (1998) indicates that the statutory financial statements are the useful source of the information for management need and purpose for very small firms, but the usefulness decreases as entities grow and expand more particular information systems. This is also reinforced by findings of Collis and others. (2001), and by Paolsoni and others. (1999) for Spain. Anyhow, SME sector altogether, Jarvis and Collis (2000) discovered that UK mandatory financial statements were not considered as being as effective and helpful as other information (as instance management accounts, budgets, bank statements, cash flow statements,) for management uses and purposes. They discuss that this is a result of large entity orientation of financial reports. Alike findings, namely that mandatory financial statements were not supposed useful for decision-making, were also reported by Healeas and Hohn (2000):

"…not many of the owner-managers have a appropriate understanding of content of the statutory accounts…They often accept the view that statutory accounts have no practical use for decision-making and promote to use a cash flow forecast and management accounts "(Healeas and John, 2000, p.7)

Similarly in Italy, while acknowledged as a legal requirement, SME statutory financial statements are not considered a helpful and effective information tool, specifically not for external customers (Paoloni et al.,1999). Nonetheless, for some small companies the mandatory financial statements (or data needed to prepare them) do meet management's information requirements. Demartini and Paoloni (1997) discuss the usefulness of financial statements for management ought be improved and that law should decide the minimum information revelation needed to safeguard the needs of those shareholders without admission to inside information.

It has also been discussed that the main purpose model of the statutory financial statements (in the United Kingdom) fails to meet the requirments of banks and owner-managers – two of the main user groups – and that a customised reporting model would be required to provide more tailored and understandable information for individual companies (Marriott and Marriott, 1999).

However, the most important problem for regulators is a considerable gap in the biography and research on the users of the SME accounts (as instance Jarvis, 1996; Dugdale and others., 1998; Jarvis and Collis, 2000; see also Paoloni and others., 1999 regarding to Spain and Italy). For example, there is a shortage of examinations of use of financial statements by public sector agencies, credit agencies, trade creditors, and other users not detected by earlier researches (Jarvis,1996).

Jarvis quarrels that the shortage of market prices for Small and Medium Firms signifies the financial statements are more necessary to external users than could be for listed firms, where market information may be more unbiased (than the financial statements). Depending on the determined gaps in research literature, Dugdale (1998) and others (e.g. Jarvis and others., 1996; Jarvis and Collis, 2000) warn against early deregulation, which might result in expanded information asymmetry, damaging effects on investment and growth of SMEs, decreased usefulness of the financial statements (Jarvis,1996) like management information tools, influencing the management quality (Dugdale et al.,1998).

Collis and others. (2001, p.182) suggest that:

> *"in relaxing the financial reporting regulation by smaller companies, the priority should not be on decreasing compliance cost, but on guaranteing that adjustments in accounting regulation cause accounts that are more effective to users."*

Cost and Benefit of IFRS for Small and Medium Entities

The 2002 EU Regulation about International Accounting Standards needs appliance of IFRSs in the listed group consolidated accounts, but includes options permitting a broader implementation for individual company accounts and non-listed enterprises. The national transformation of Regulation and company options and the member state have given progress to a lively debate. Tables 1 and 2 summaries the key arguments made, respectively, for and against the implementation of IFRSs in accounts of individual companies.

Although Marten and others (2002) suggest, depending on German information, that non-listed companies underestimate the advantages of IFRSs, their benefits are usually discussed to be less authentic in the SMEs context. In that context, the most important argument in their favor is harmony of Germany accounting (Mandler,2004). So the German literature needs an exception from IFRSs for smaller firms. For SMEs the implementing costs of IFRSs far exceed benefits and advantages, and there is a limited demand for (international) comparability (Haller,2003).

Further, SMEs depend on debt finance supported by their bank, they do not depend on the capital market (Mandler,2004). Additionally, Mandler (2003) identifies that, likely the multi-purpose function of the German financial statements, especially SMEs have in the past got advantage from the demand to prepare just one set of the financial statements, that also serves for taxation purposes; this advantage would be lost and independent tax and financial accounts would ought to be prepared.

Finally, German SMEs have not traditionally been in favor of transparency and commonly prevented publication of their result. They would therefore be affected most by additional disclosure/publication requirements (Mandler,2003,2004); this is, greater transparency can in fact be harmful (see also Haller,2003). Mandler (2003) reports conclusions of 2002 survey of SMEs and academics on German financial reporting reform.

The writer found considerable dissimilarities in the views of larger (250 employees) and smaller SMEs, with the previous opposed to obligatory introduction of IFRSs, and the option supported only weakly. The larger SMEs were much more strongly for the option. Academics were much keener about reform, but not for options.

The survey of large North-Rhine Westphalian SMEs performed by German KPMG and von Keitz discovered that factors affecting companies' judgment for or against accomplishment of (full) IFRSs contain the legal form, membership, size of a group previously applying IFRSs, and actual or planned external rating throughout rating agencies. Two-thirds of non-listed companies plan to or already have adapted and changed to IFRSs; of those undecided, a farther 80% would change if the IASB published promoted and expedited requirements for SMEs (Anon.,2004).

Such an option is examined among others by Haller (2003). Haller16 quarrels that the EU options can lead to greater discord, lest there is some member state union in regulation of reporting for non-listed companies. He farther suggests that settled national principles ought to be introduced into the discussion concerning the international development and establishment of accounting and accounting standards and recommends means of facilitating a wider adoption of IFRSs in the national systems.

One step could be the development of the International Financial Reporting Standard for the Smaller Entities (IFRSSE) by IASB, that would wane the argument of benefit/poor cost ratios for implementing of IFRSs by SMEs. This opinion is also taken by Eierle and Haller (2004).

Refered to cost/benefit aspects, and the presumption of the development of the IFRSSE, Eierle (2004) recommends a model for differential reporting on basis of the IFRSs/IFRSSE for all companies in Germany. This is depend on arguments of the legal clarity and uniformity, increased information value and consistency to users. It is also in line with EU’s long-term aim of the harmonized regulatory accounting framework.

Further advantages of the IFRSSE would be easier accomplishment of the member state option to accept IFRSs also for non-listed companies and creation of more coherent and steady national accounting system. This could serve international and national comparability and easy transition to the full IFRSs for companies aiming for the capital market listing. In addition, many transitional economies should follow World Bank requirements for applying (full) IFRSs to all companies and firms, which is much too demanding for SMEs (Eierle and Haller,2004).

Conceptual Problems

Central difficulties for implementation and development of an IFRSSE are considered conceptual problems and differences. As instance, in the situation of UK differential reporting, this cannot necessarily be presumed that the conceptual framework, Statement of Principles, and its fundamental principles and theories (which are depend on the information requirements of large public company shareholders), are equally appropriate to SMEs (see, as instance Jarvis and Collis,2000).

Agency relationships differentiate and small entities usually engage in different strategies, are more probable to satisfice, and aiming for stability and survival rather than growth and profit-maximization (ibid.; see also Lawrence and Hamilton,2001). Further: '. . .the stewardship function is largely missing in small entities an firms. Instead, the accounts show up to play the agency role between the owner-managers and the bank' (Collis and Jarvis,2000). Therefore a 'large company template' can be unsuitable for SMEs. Rather, regulators have to examine how owner-managers are using statutory accounts and deal with developing the conceptual framework for SMEs.

The Italian literature proposes that, before examining the requirement for the specific set of rules in order to prepare SME financial statements, we have to address what we recognize the main goal and aim of financial reporting. This question can be considered as a prerequisite to determination of the consistent set of the accounting principles.

The central issue is how to conciliate a desired consistency of purposes of the financial statements and the accounting principles with the different and specific informative requirements of users (Amaduzzi,1949). Therefore the question of if a single set of the rules for the formation of the financial statements could be to address all user requirements, or whether different frameworks are needed or demanded (‘multiplicity’ or singleness’ ‘of financial statements) has been largely debated in Italy.

The agreement of this theoretical debate in Italy seems to be that a single conceptual framework with, in principle, the same purpose for financial reporting and same framework of accounting principles and rules should be applicable to all companies, but with some distinction based on sector, the requirements of the firm size and tax authorities. Financial statements have to be designed to provide helpful and effective information for the requirements of different categories of users (fiscal authorities,creditors, banks, investors, suppliers, customers, etc.).

The common purpose of financial reporting, as recognized by Italian theorists, is a provision of information on the ability and size of firms to create income (reddito) (Zappa,1950). Therefore, although some differential reporting could be required with regarding to specific circumstances, it would influence specific detailed regulations only, but not the subordinate principles of financial reporting.

Same accounting principles should be implemented to all firms; various sets of principles would not be needed. It is, nonetheless, questionable if the IASB’s Framework is a universally suitable and convenient conceptual framework.

It follows from the following that, if the IASB Framework was depend on a general idea regarding to the objectives and purposes of financial statements, then this should be recognized useful for each category of company, SMEs included. IFRSs have to be suitable for all firms and companies. However, if the Framework’s stated objective for preparation of the financial statements was, as is currently the case, less general, the accounting principles would not be suitable for all firms.

The IASB Framework’s and standards’ essential target is on firms with securities listed on international capital markets, that is, firms with public accountability. That they are also recognized to have this focus is obvious from the fact that actually the largest body of literature addressing the IFRSs and their implementation relates to large and listed firms. Therefore, the Framework's purposes of financial statements are not in line with the requirements of SMEs. This indicates that the IASB should either extend its focus by modifying the Framework's present version beyond the large and listed firms, or develop a separate conceptual framework and set of IFRSs provision for SMEs.

Vehmanen and Riistama (2004) also disagree with the IASB's assumption that GAAP for SMEs could be developed based on existing IFRSs, relying on the same concepts. They discuss that IFRSs are developed for the large and multinational enterprises, which raise finance globally and consequently also need global accounting rules. The much larger number of SMEs and not-for-profit organizations worldwide face various conditions, operate locally and depend on different forms of funding, and operate frequently with no or little separation of control and ownership. The fair value of their assets is often impossible to determine because it depends on the firms' ability to (continue) operate. This gives rise to a demand for various qualitative characteristics and a various accounting framework.

Among the conceptual problems that should be considered, there is finally the relative nature of the notion of the SME. Given the attempts in both academic literature and by statistical institutions (such as Eurostat), it becomes evident how difficult it is to reach a definition for a small or a medium-sized company. The solutions, which anticipate the recourse to one or more parameters of the quantitative type (receivable total, sales proceeds value, number of employees, etc.) are not effective in this sense.

The identification of these parameters is subjective and appears to be strongly conditioned by the economic context of a certain country, by the business sector, and by the organizational solutions adopted by a particular company. Consequently, it is not simple to decide which of two SMEs may be the smaller. The contributions in the literature stress this character of relativity.

The Discussion Paper's proposals to extend IAS/IFRS to publicly accountable SMEs, or alternatively the creation of a specific set of standards for a category of companies so difficult and subjective to identify, are therefore difficult to interpret.

SME and IFRS in Azerbaijan

The Republic of Azerbaijan has regained its independence in 1991, following the destruction of Soviet Union. During the first years of independence the economy of Azerbaijan has experienced significant hardship. The economic slowdown started in Azerbaijan during the late 1980s. The economic reforms implemented by Gorbachev starting since 1985 did not provide expected results and the economic output has decreased. The collapse of the Soviet Union has further disrupted the economic ties between member countries. To make the situation even worse, Armenian military forces had invaded West-side of the Republic of Azerbaijan and Azerbaijan was involved in a war with Armenia.

The economic and political crisis continued until the late 1993. In 1994, the national leader of the country, Heydar Aliyev, through the wise politics has improved socio-economic situation in the country. The cease-fire agreement with Armenia followed by the signature of the “Contract of the Century” has brought stability to the country and attracted multinational foreign investors.

Production Sharing Agreement regarding the exploration of the oil and gas resources in the Caspian Sea (also known as the Contract of the Century due to its importance to the Republic of Azerbaijan) has resulted in significant capital inflow, which was used to rebuilt the economy of Azerbaijan.

The launch of Baku Tbilisi Ceyhan pipeline has further stimulated the growth of the economy due to additional capital inflow from the delivery of oil and gas to foreign markets. As a result of this, Azerbaijan has achieved the highest GDP growth figures two years back to back. The capital resources from oil and gas sector was directed to the developed of non-oil sector. Special attention was distributed to the development of construction sector, agricultural sector, establishment of trade and transit relationship among neighboring countries.

The economic growth in Azerbaijan was also accompanied by the economic integration of the country into the world economy. Inherited accounting and regulatory framework of the Soviet Union did not fit into the foreign model of the business. Various reforms by the President of Azerbaijan Republic in the sphere of tax, accounting, and finance has facilitated the growth of the economy.

Even though in the initial stages of the development of the economy, Azerbaijan was the recipient of foreign direct investment in subsequent years the Azerbaijani companies started investing abroad. Increased bilateral relationship would have not been achieved without the adoption of International Financial Reporting Standard in the accounting practice. International financial organizations and institutions required audited financial statements under IFRS in order to invest in foreign countries, to be involved in foreign tenders, or to borrow from International Banks.

On the one hand the adoption of IFRS helped the firms to go international. On the other hand, however, the ability to participate in foreign transactions, to attract foreign investors, or source of capital from foreign governments can be performed only by large companies. This raises the question of necessity of IFRS for SMEs.

In contrast to the European Union countries, such as Germany, Italy, France, the SME in Azerbaijan do not represent the significant portion of the total output produced by the economy. Nevertheless, the state officials understand the importance of the SME for the overall economy. For example, SME are less vulnerable to economic crisis than large and multinational enterprises.

The decree of the President of Azerbaijan Republic, dated October 25, 2007 “Ensuring measures of organization of entrepreneurship subjects’ activity on the single window principle” has facilitated the establishment of SMEs. The government of Azerbaijan has undertaken various steps to facilitate and liberalize the entrepreneurship activity of SME. According to the decree of the Cabinet of Ministers dated December 18, 2009 the following entities are considered SMEs from the legislation perspective:

- Industry and Construction sector. Number of employees less than 50, with annual turnover of less than 500 thousand AZN (excluding VAT and other applicable taxes)
- Agriculture sector. The number of employees below 25, with annual turnover of less 250 thousand AZN (excluding VAT and other applicable taxes)
- Wholesale Trade sector. Number of employees below 15 with annual turnover of less than 1 million AZN (excluding VAT and other applicable taxes)
- Retail trade, transportation, service and other economic activities. Number of employees less than 10, with annual turnover of less than 250 thousand AZN (excluding VAT and other applicable taxes)

The concentration of the newly established SMEs are mainly centered around Baku and neighboring areas. According to the Ministry of Economics of Azerbaijan, more than 50.7 percent of newly established SMEs are located within Baku and its

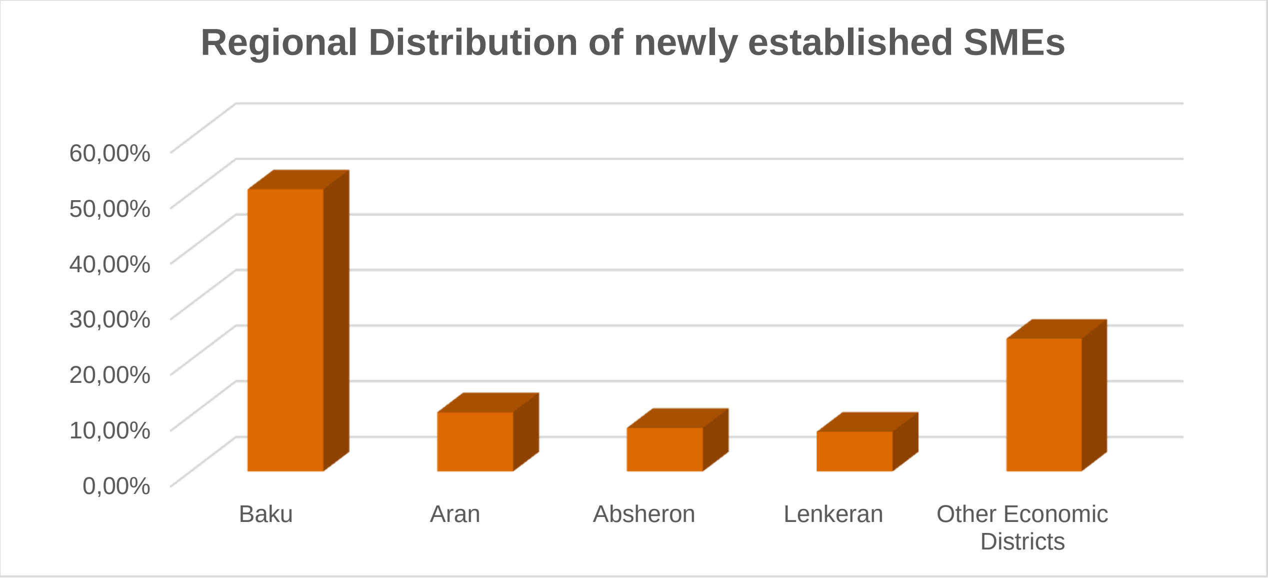

Figure 1. Regional Distribution of Newly Established SMEs. Source: Ministry of Economics of the Republic of Azerbaijan

neighboring areas.

Methodology and Results

Qualitative Design

To analyse the importance of SMEs in the Republic of Azerbaijan, I utilize quantitative and qualitative research techniques. Considering the nature of the research, I believe that the best option to analyse the suitability of IFRS for SMEs for local SMEs is the combination of the both methods. The qualitative research techniques utilized are based on questioning analogy. Therefore, from qualitative part of research design perspective I will use the short questions that will debrief the matter under the study.

The designed questions will be directed toward the management/owners of the SMEs as well as towards management/owners of large corporations. Additionally, the insight will be gained through questioning the audit specialists of Big 4 audit companies.

The designed questions are prepared in a manner that will reveal the most of the information regarding the topic of the research paper. The full details of questions asked during the process is listed in Appendix.

The table below lists interviewees and their respective position at their company.

Table 1. List of Interviewees

Name, Last Name	Company	Position
Tamraz, Rzayev	PricewaterhouseCoopers Audit	Senior Associate
Yusifbay, Safarli	PricewaterhouseCoopers Audit	Senior Associate
Tural, Agayev	PricewaterhouseCoopers Audit	Manager
Emil Alikhanbekov	ATEF Group of Companies	Shareholder, Head of Supervisory Board
Aliaga, Namazov	Dadli Bakery, LLC	Sole Trader

Quantitative Design

It is quite clear that adoption of IFRS is costly. The companies wishing to adopt to IFRS spend costs on it. Those costs range from paying to a qualified employee to paying the auditor fees for audit. Therefore, the company willing to incur costs in order to report under IFRS should have benefits. Otherwise reporting under IFRS would make no sense from rationality perspective.

Therefore, to analyse the impact of IFRS for SMEs from the cost and benefit analysis is very important to understand why Small- and Medium-based Entities would report under IFRS. As literature review has revealed one of the most common goals in referring to reporting under IFRS is the ease to obtain funds from banks, and other sources. However, in contrast, to public and large companies, the source of capital is significantly limited to the SMEs.

The main source of finance for SMEs is the banks. Therefore, it can be argued that companies with IFRS reporting should have higher access to loans from banks. As such, I stipulate that among European SMEs, those with IFRS reporting have higher loan amount. I selected the data available for SMEs for the year-ended 31 December

2017 for Italy, Germany, United Kingdom, Spain and France due to higher percentage of SMEs in those countries.

$$Bank\ Loans = \alpha + \beta_1 Profit + \beta_2 IFRS\ Report + \beta_3 Total\ Assets + \varepsilon$$

Based on the equation above I stipulate that, to obtain bank loan the company needs to be profitable, big, and have IFRS reporting. The table below provides the definition of each of variables under study. In this equation IFRS reporting is a dummy variable and equals to 1 if the company report under IFRS and zero otherwise.

Table 2. Definitions of Variables

Variable Name	Definition
Bank Loans	Bank loans represent the funds borrowed from the bank. The main argument is that companies with IFRS reporting should have ease of access to funds from banks.
Profitability	Profitability represents the profits earned by the company in the current year. From the economic and business rationale, the banks are more willing to lend money to profitable business rather than unprofitable one.
IFRS	IFRS stands for reporting under International Financial Reporting Standards. The variable is a dummy variable and equals to one for companies reporting under IFRS and zero otherwise.
Total Assets	Total Assets represents the size of the company. Usually banks are more willing to lend to companies who have more assets. This is explained by the fact that higher amount of assets means higher amount of collateral to pledge to the bank.

Results

The following tables represents the results obtained from the regression analysis.

Table 3. Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.962[a]	.912	.902	420.849	2.01

a. Predictors: (Constant), Profit, IFRS Report, Asset
b. Dependent Variable: Bank Loans

Based on results of the regression, R-square and Adjusted R-square equal to 91.2 and 90.2 percent, respectively. This means that independent variables in the equation explain 90.2 percent movement in dependent variable.

Table 4. Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
	B	Std. Error	Beta			Lower Bound	Upper Bound
1 (Constant)	228.037	698.893		.326	.754	-1424.582	1880.656
Profit	13.666	.118	.768	5.666	.001	.388	.944
IFRS Reporting	.304	.231	.373	.483	.435	.293	.313
Asset	4.589	11.779	.249	1.833	.099	-6.264	49.441

a. Dependent Variable: Bank Loans

Based on the results of the regression equation it is clear that profit and Total Assets have direct positive impact on the amount of Bank loans. The statistical significance coefficients are 1 and 10 percent, respectively. However, the results of the regression equation suggests that IFRS Reporting does not have any significant impact on the bank borrowings. The statistical coefficient is not statistically significant at any percent level of statistical significance.

Data Validity Check

To obtain credibility about the population parameters I utilize the Kolmogorov-Smirnov and Shapiro-Wilk test. The results are presented below.

Table 5. Population Parameters Test

	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Bank Loans	.173	560	.43	.847	560	.22
Profit	.290	560	.27	.763	560	.39
IFRS Reporting	.344	560	.24	.562	560	.34
Asset Size	.145	560	.52	.562	560	.56

*. This is a lower bound of the true significance.

a. Lilliefors Significance Correction

Based on the results of Kolmogorov-Smirnov test and Shapiro-Wilk test none of the variable are statistically significant indicating the all variables under study have distributions which at least similar to the distribution parameters of the normal distributions.

The next table presents the results of the Kaiser-Meyer-Olkin test and also presents the anti-image correlation matrix.

Table 6. Kaiser-Meyer-Olkin Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.817
Bartlett's Test of Sphericity	Approx. Chi-Square	517
	Df	560
	Sig.	.000

Based on the obtained results, Bartlett’s test of Sphrericity has statistical significance at 1 percent, indicating that variables under the study fits the designed model. Kaiser-Meter-Olkin test results suggest the sampling adequacy coefficient of 0.817, which indicates that sampling is adequate. As a general rule of thumb, Kaiser-Meyer-Olkin test results exceeding sampling adequacy coefficient of 0.817 indicates the appropriate sampling adequacy.

Next I present the results of the anti-image correlation matrix.

Table 7. Anti-Image Correlation Matrix

		Profit	IFRS Reporting	Asset Size
	Profit	.626[a]	-.225	-.056
	IFRS Reporting	-.225	0.562[a]	.612
	Asset Size	-.056	.612	.597[a]

According to the anti-image correlation matrix, the correlation coefficients between variables all exceed 0.50, which is according to the general rule of thumb is appropriate level to be accepted for the sampling purposes. Therefore, none of the variables in the model have been dropped.

Conclusion and Implication

Findings and Discussion of Results

To understand the usefulness of International Financial Reporting Standards in the Republic of Azerbaijan, I have inquired auditors from the PricewaterhouseCoopers Audit. PwC as one of the first Big 4 audit companies entered the Azerbaijani market very early in 1996. In the first years of operation, the audit clients of PwC in Azerbaijan were mainly local offices of large international companies. Subsequently, this trend has changed and Azerbaijani companies were also adopting the IFRS.

Therefore, it can be said that PwC has played significant role in establishment the practice of adopting the IFRS for local companies. Due to this, I decided to obtain valuable insight into the IFRS from current auditors of PwC. First I interviewed Tamraz Rzayev, who has been with PwC for a period of more than 3 years.

The response provided by Tamraz, was very valuable. Below I summarize the key extracts from the interview with Tamraz.

> *"The International Financial Reporting Standards have been applied by a large number of companies in Azerbaijan. Nevertheless, if we look at it from the country perspective, the amount of companies adopted IFRS is still very low compared to the European Countries, especially to Western European Countries. This is mainly caused by the fact that people do not understand the purpose of IFRS and assumes that adoption of IFRS require significant costs. Additionally, from my experience I can tell that management of companies especially where managers and shareholders are the same people, do not understand the value of IFRS. As such I have seen a lot of companies which do not fall under classification of Small and Medium-sized entities, but still do not use IFRS. Indeed, it is very important to understand what value will reporting under IFRS bring to the company before deciding whether to adopt IFRS or not. Shareholders who are at the same time managers also, believe that they are aware of the current position of the company and do not need an advice*

from external people. In reality however, the financial position of such companies are messy. There are a lot of companies which at first glance operate at profit, but when transforming their financial situation into IFRS, it appears that the company has been loss making for a significant period of time. Therefore, I think it is necessary to improve the awareness of IFRS and insights it can bring to companies in Azerbaijan. Regarding the application of IFRS for SMEs I find it very difficult and challenging. During the past three/four years I have not seen SME which required reporting under IFRS".

Another respondent was Yusifbay Safarli, Senior Associate from PwC, who has also been in audit for more than 3 years. The extract below summarizes the key points mentioned by Yusifbay.

"I think it is important to understand why you need the International Financial Reporting Standards. This issues ties to understanding the needs of the user of Financial Statements. In the Republic of Azerbaijan, IFRS reporting is mandatory for Banking Institutions based on legislation of Central Bank of Republic of Azerbaijan, State of Oil Fund of Azerbaijan, as well as state owned entities based on the Presidential Decree of Mr. Ilham Aliyev. Companies aside those required to report under IFRS, have some purposes for doing so. Before the devaluation of national currency has occurred in 2015, a lot of construction companies were reporting under IFRS in order to be able to participate in tender contracts of foreign companies in Azerbaijan. However, following the economic slowdown in construction sector, the number of companies in construction sector reporting under IFRS has suddenly decreased. I think there are also companies who report under IFRS in order to show shareholders operational results, which are not distorted by the management of the entity. As such the shareholder of the financial statements uses the financial reports to evaluate the performance of management. And finally, the local companies use IFRS to obtain funds from foreign countries.

Prior to devaluation the national currency, this was probably the most important reason of reporting under IFRS. Due to high interest rates at local banks, companies were referring to foreign banks to borrow money. However, the rapidly increasing value of USD and subsequent high volatility of it has brought uncertainty to the market. Therefore, borrowing from foreign countries in foreign currencies became risky. On a very few occasions, the companies were reporting under IFRS in order to invest in foreign countries (especially in European countries). Based on the understanding of needs for IFRS, I really doubt that SMEs in Azerbaijan will refer to the foreign banks, or report under IFRS to evaluate performance of the management, since the small size of the entity allows shareholder to review it without IFRS.

Another interviewee was Tural Agayev, manager at PwC. The extract below highlights the key points emphasized by Tural.

"I do not think that IFRS is suitable for Small and Medium-sized entities in *Azerbaijan or in other country. Based on my experience, even Small and Medium-sized entities in Japan do not utilize the IFRS. I think this is conceptual problem which relates to the very basic question upon which the whole Conceptual Framework is built. What are the needs of users? According to the legislation of the Republic of Azerbaijan, SMEs are comprised of entities not exceeding annual turnover of 1 million and even for some industries and types of businesses this amount is lower. The question arises why would company who has annual turnover of 100,000 AZN report under IFRS? What are benefits of reporting under IFRS? It is clear that reporting under IFRS is not cheap. The preparation of financial statements under IFRS should be followed by the audit of those financial statements. While the preparation of financial statements require a qualified and competent employee, the audit requires the money to be spent on the audit. It also should be mentioned that compensation for a qualified and competent employee with throughout*

knowledge of IFRS would be above the market rates. If assuming that monthly compensation of employee would be 1,500 AZN per month and the audit would cost 10,000 AZN, then the entity with annual turnover of 100,000 AZN will incur 28,000 AZN just to report under IFRS. I am 100 percent sure that for SMEs this amount is very burdensome.

Another interviewee is the shareholder and Head of Supervisory Board of ATEG Group of Companies. First, I will present brief information about ATEF Group of Companies. ATEF Group of Companies LLC has been legally founded during 1997. Nevertheless, the history of the company dates back to1960s. During 1960s, Baku Transformer Plant has been established, with the primary purpose of manufacturing and supplying dry type transformers. Due to the unique nature of operation, the transformer plant has been of strategical importance for the Soviet Union.

The collapse of the Soviet Union has undermined operation of the Baku Transformer Plant as well. Following years of stagnation, the entity has been privatized during 1997 by Talib Alikhanbayov and renamed into ATEF Group. The electrical engineering knowledge of Mr. Talib Alikhanbayov has allowed him in a brief period of time to restoration of the operation of the factory. As such, starting since 1997 the factory has continued the production of dry type transformers. the crucial factor in establishment of ATEF Group of Companies as one of the leading companies in manufacturing sector is the signature of the Baku Tbilisi Kars railway contract. After announcement of the tender for electrification of Baku Tbilisi Kars railway system, ATEF Group of Companies have been awarded with the contract. This was the most important event in the history of operation of the entity. Subsequent cash inflows from the multi million project have been wisely invested into the expansion of operation both locally and internationally.

At the initial stages significant cash flow received from the commencement of the project has been directed on modernization of the facilities and search for new contracts and projects abroad. As such several projects have been awarded in the

Republic of Kazakhstan. Alongside that strategy was designed in order to enter markets of Central Asia, Middle East, North Africa and Eastern Europe.

This strategy also turned out to be successful. Even though the operation with some countries did not work out, during the period from 2010 to 2017 various exports to Ukraine, Russia, Egypt, Afghanistan, Iraq, Iran, Georgia, Turkmenistan, Bulgaria, etc. were made. As such ATEF Group of Companies became the first Azerbaijani company which exported non-oil goods to more than 2 or 3 countries for the long period of time.

In order to continue the operation in international markets the management of the entity has invested in construction of new plants. As for example, ATEF Steel Construction Plant has been established in 2013. During 2015, however, ATEF Large Size Transformer Plant has been established and exploited. During 2017, new transformer plant has been established in the Russian Federation.

As a way of maximizing revenues, the management of the entity understand the need to expand into international markets. Therefore, the entity is always represented in International Expos Middle East, Russia, Africa, and so on.

The below are extract from the interview with Emil Alikhanbekov.

> *"Following the rapid growth of the company and motivated by wide adoption of International Financial Reporting Standards, we decided to adopt IFRS reporting. With high hopes we adopted the IFRS as our accounting standards for preparation the company's financial statements. Despite the large costs spent on adoption of IFRS we have not seen any advantage of reporting under IFRS. ATEF Group of Companies is a large company with constantly increasing presence in post-Soviet Union countries. Currently, several factories are built in post-Soviet countries, however, the adoption of IFRS has not played any role in our development. In order to participate in tenders in Soviet Union countries the provision of financial statements is enough; there*

are no requirements for IFRS financial statements. Our company also did not observe the benefits in obtaining financing from external resources. Our company has never experienced an issue in obtaining financing given that proper collateral is provided. The same issue continued even after the company were audited under IFRS. From the perspective of presenting fair information to shareholder, no positive movement has also been observed. The significant judgement in IFRS allows dubious interpretation of various issues, which then becomes more problematic to solve. As such I do not think that reporting under IFRS can bring any advantages to SMEs."

Final interviewee is Aliaga Namazov, founder and Chief Executive Officer of Dadli Bakery LLC. Dadli Bakery LLC was established by Aliaga Namazov himself. The following presents the extract from the interview.

"*I have heard about the International Financial Reporting Standards but do not have any experience with it. I have also heard that application of IFRS is costly for firms, especially for SMEs. Therefore, I think that in order for SMEs like my business to adopt the IFRS, there should be clear advantages of it. Those advantages should not be theoretical but rather practical. The company with turnover of less than 100,000 AZN does not need to report under IFRS to understand the ongoing issues in their accounting. Additionally, I do not think that reporting under IFRS will somehow facilitate the external financing raising. Especially, considering the fact that the major and primary source of finance for SMEs are bank loans".*

The summary of responses of interviewees are summarized in the next section.

Conclusion

As was stated before the International Financial Reporting Standards and International Accounting Standards have been developed with the main purpose of simplifying the exchange of accounting information between various corporations worldwide. The rapid development of world economies and particularly of Small and Medium-sized entities has created the need for adopting the unified set of accounting standards. As was mentioned before, International Accounting Standards Board (Body responsible for adoption of IFRS) fearing that standards developed by local Accounting regulatory will not follow the conceptual framework, made an announcement regarding the publication of IFRS for Small and Medium-sized entities.

Nevertheless, it should be mentioned that the key auditorium of IFRS were and still are the large international and public companies. As such IFRS ignores the demands in financial reporting and accounting requirements for Small and Medium-sized entities.

Upon noticing the fact that state regulatory agencies of various government started working on modifying the requirements for SMEs, IASB fearing the fact that new accounting framework may not follow the Conceptual Framework developed by IASB issued draft exposure on IFRS for Small and Medium-sized Entities. This draft exposure revealed various weaknesses of the new reporting guideline developed by IASB. Particularly:

- Within the EU, SMEs have noticeable economic significance; these firms are subject to the reporting regimes that provide various degrees of exemptions.
- User groups of SME financial statement and their requirements differentiate from users and user requirements of large, public-interest companies. There are also important differences between user groups of the smallest against the larger SMEs.

- Findings regarding the benefits and costs of reporting by SMEs are inconsistent and changeable, even with the same regulatory framework. There is a significant gap in existing research literature at users and user needs of SMEs, and especially the actual needs, requirements and views of owner-managers. Instead, moves for differential reporting are usually driven by other groups, including practitioners and academics.
- Arguments for differential reporting frequently relate to undue burdens and disproportionate costs including a perceived lack of appropriateness of statutory accounts to main user groups.
- The fundamental and essential arguments against differential reporting are a need for universality, the demand for comparability, perception, and the reliability that statutory financial statements convince some information requirements and provide some protection to shareholders without access to inside information.
- The IASB *Framework*'s concepts and objective of financial reporting appear prejudiced towards large companies with public accountability. However, for SME reporting, strategies, objectives and accountability relationships differentiate. Therefore, the concepts and objectives underlying IFRSs may not be appropriate and convenient for SMEs. A various and contrasting conceptual framework may be required.
- The advantages of implementation of IFRS quoted in the literature are considered usually less convincing in situation of SMEs. Costs are considered to exceed benefits. Larger SMEs are disposed more favorably towards IFRSs.
- The effective mechanism is needed to ensure compliance, enforcement and coherent and compatible application of SME standards.

Further using the quantitative methods, I analyzed the impact of reporting under IFRS for SMEs for the ability of the entity to borrow from banks. Based on the analysis for 2017, from the sample of Italy, Germany, United Kingdom and France, I could not identify the positive impact of having the IFRS reporting and amount of bank loans. The statistical coefficient was not statistically significant at any percent of statistical significance.

Based on the finding above it seems that reporting under IFRS does not have any impact on the entity's ability to raise external financing. Considering the fact that major source of financing for SMEs are bank loans, it seems that reporting under IFRS is not that required. Additionally, it should be mentioned that there are claims that reporting under IFRS reveals useful information for management that are otherwise hidden within accounting figures. I believe that this might be an issue for companies which Medium-sized companies and are on the verge of becoming large company. The analysis of cost and benefit of reporting under IFRS in the United Kingdom has revealed that for companies with higher than 1 million GBP annual turnover, reporting under IFRS brings new positive challenges and benefits. However, the company with annual turnover of less than 1 million GBP mainly incur significant costs.

The interview with various professional and business owners in the Azerbaijan, has revealed that application of IFRS for SMEs in Azerbaijan will not result in positive aspects for the company. SMEs in Azerbaijan are comprised of companies with annual turnover of less than 1 million AZN in retail sector, and less 250 thousand in other sectors. Costs of more than 30 thousands AZN per year spent for the purposes of reporting under IFRS are excessively significant for small companies. The result of inquiries with business professionals revealed that even large companies in Azerbaijan with significant turnover not always observe the benefits of reporting under IFRS. As such the benefit of reporting under IFRS for SMEs are even the less likely to happen.

The interviews with auditors revealed that large companies do use International Financial Reporting Standards as a basis for accounting reporting, but this decision is closely related to their business strategy. As such it is easy to state reporting under IFRS provides benefits but only in limited circumstances. Those circumstances relate to the operational activity of the company and long-term strategic vision of the company. Based on the fact that even for large companies IFRS provides benefits in limited circumstances, for SMEs these circumstances even more scarce.

Limitations

The primary limitation of the research is related to the number of interviews made to arrive at assessment of suitability of IFRS for SMEs for SMEs in Azerbaijan. During the research, I only interviewed 5 business professionals/managers from the business world. I believe that survey type analysis with more participants from the industry would have yielded better results and better picture of the current market situation in Azerbaijan.

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Appendix 1.

List of Questions

1. What is the main purpose of IFRS?
2. How reporting under IFRS would help an entity to develop?
3. Do you think that reporting under IFRS is cost burden?
4. Have you seen a case when reporting under IFRS yield positive results on development of the company?
5. Should Small and Medium-sized companies adopt IFRS in Azerbaijan?