Perceptions of Sri Lankan Unit Trusts' Stakeholders on Converging with International Financial Reporting Standards

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Introduction

The scores of studies carried out on converging of local accounting standards of countries with International Financial Reporting Standards ("IFRS Convergence") emphasize its emerging importance in the global arena. It has been recognized that a significant portion of entities largely affected by IFRS Convergence are financial institutions due to the novel concept of "fair value accounting". According to past studies in the international context, mutual funds, form an emerging category of financial institutions that are impacted by IFRS Convergence is significant. Mutual funds are defined as institutions that pool funds for investment, which allows them to reduce risks through diversification and achieve economies of scale.

In the Sri Lankan context, mutual funds, commonly referred to as unit trusts, are passing through a stage of rapid growth and attraction. The number of Fund Management Companies (FMCs) that manage the unit trust funds' investment activities have more than doubled in number within the past two years, leading to a total of thirteen FMCs by November 2013 (compared to six in May 2011). The total assets held by unit trusts have more than doubled from Rs. 22.7 billion in end 2011 to Rs. 47.3 billion by end 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 of unit trusts, formulated a ten-year master plan for developing the unit trust industry in 2006 and took measures to conduct awareness campaigns on unit trust investments.

Problem Statement

Despite this emerging importance of unit trusts in the country, prior literature on the industry is scarce, and none address the domain of financial reporting and the impact of IFRS Convergence implemented from January

2012. Hence, this study strives to address the question: "*How do stakeholders of Sri Lankan unit trusts perceive the impact created by IFRS Convergence?"*

Objectives of the Study

The objectives of the study are to evaluate perceptions of stakeholders of unit trusts on IFRS Convergence, identify and analyse the challenges faced by Sri Lanka's unit trusts when implementing the changes and provide an explanation to perceptions of stakeholders by referring to the challenges they face.

Methodology

Conducted in the form of a descriptive case study, the study uses data and method triangulation through observation, semi-structured interviews and questionnaires covering four stakeholder clusters of unit trusts, namely; FMCs who manage the funds; Trustees who safeguard the unit holders' interests; the Institute of Chartered Accountants of Sri Lanka (ICASL) which promulgates financial reporting standards in Sri Lanka; and the SEC which acts as the regulator.

When analysing the stakeholder perceptions, the strategic options evaluation model by Johnson et al. (2008) is used. This model has been initially developed as a framework to evaluate the impact of strategies to a particular entity. In this study, considering the unit trust industry as a single entity, IFRS Convergence is viewed as a new strategy with the objective of improving quality of financial reporting. 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 in the entity possesses. In analysing the challenges, the order of significance is ascertained using rankings provided by the stakeholders, which is compared across stakeholder groups and matched against their respective perceptions.

Key Findings

The study identifies that the four different stakeholder clusters have varying perceptions on IFRS Convergence. FMCs perceive IFRS Convergence to be acceptable to the stakeholders and suitable since it addresses issues in the existing reporting procedure and is favourable to the future direction of the industry. However, serious doubts are raised regarding the feasibility for unit trusts to successfully comply with SLFRS/LKAS, especially due to limitations in time and knowledge. Trustees perceive IFRS Convergence to be suitable to unit trust industry and generally acceptable to stakeholders. However, they too harbour a strongly negative perception about feasibility because of the poor status of the country's financial infrastructure, limitations in the existing information systems of FMCs, insufficient consultancy 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 while the SEC's perceives that no material change will occur to unit trusts' financial reporting as a result of IFRS Convergence.

The implementation challenges faced by unit trusts when complying with SLFRS/LKAS identified in the study can be broadly classified as process related, time related, knowledge related and execution related. Process-related constraints, emerging from disclosure requirements and the need to segregate transaction costs from fair value of financial assets, are emphasized by Trustees and FMCs as the most significant challenges faced. Time constraints are also highlighted by the FMCs, although part of the blame appears to rest on the FMCs themselves for not preparing for the required changes in advance. Knowledge constraints, including both FMCs' knowledge on SLFRS/LKAS and mechanisms for getting issues clarified from external sources, are considered significant by the Trustee, although not openly admitted by the FMCs. In addition, underlying issues relating to the execution of IFRS Convergence that amplify these challenges are also observed, including inadequate attention provided to the unit trust industry by the ICASL and the SEC in the process of IFRS Convergence and meagre communication between stakeholders of the unit trust industry with respect to IFRS Convergence. However, the ICASL and the SEC were unaware of any of these implementation challenges.

Conclusion

By matching the identified challenges against the perceptions of stakeholder clusters, the study concludes that reservations regarding the feasibility of IFRS Convergence by Trustees and FMCs can be explained by the implementation challenges they face. In particular, the main implementation challenges identified by the Trustees and the FMCs – process-related constraints, knowledge constraints and time constraints – could be the reason behind their reservations regarding feasibility of complying with SLFRS/LKAS, despite acknowledging suitability and acceptability. Furthermore, the positive perception of the ICASL regarding feasibility can be appropriated to its role in promoting IFRS Convergence. The uninformed state of the SEC as the regulator can be explained by its focus on legal aspects rather than financial reporting aspects. It also indicates possible issues of poor communication.

These findings will be important for policy setters in Sri Lanka to manage future changes in financial reporting, such as the introduction of *SLFRS 9 - Financial Instruments* in January 2015, efficiently and effectively. It will also provide an insight for other countries that are planning for IFRS Convergence in the future, to achieve a smooth transition with least resistance.

Key Words: Unit Trusts, IFRS, Convergence, Financial Reporting

References

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