

Accounting and Financial Reporting Practices of SMEs: Bangladesh Perspective

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Abstract

This article presents an empirical investigation of accounting and financial reporting practices of SMEs of Bangladesh. The primary data were collected from the total number of 100 Accountants/ managers using a structured questionnaire. This study reveals that 44% of SMEs keep accounting records which are mainly Profit and loss Account, Bank Statement, Balance Sheet, Cash Flow statement etc respectively and the main purpose of keeping records is to track the receivables and payables, to support in accessing credit/finance and to evaluate performance. 56% of SMEs do not keep accounting records because they perceive that it is difficult to maintain the system as well as unnecessary even It makes the enterprise to pay more tax. However they also provide suggestion to improve the accounting practices by Educate managers/owners on the need to keep accounting records, Motivate managers/owners to adopt accounting records, strengthen monitoring and supervision by the Government. The firms which maintain Accounting and financial records have an effect on the financial performance (ROI). Therefore, in order to improve the accounting and financial practices of SMEs, the concerned authority needs to implement the suggestions put forward by the respondents without any further delay.

Keywords: SMEs, Accounting Records, Motivation, Challenges, Suggestion.

JEL Codes:

1 Introduction

The contribution of Small and Medium Enterprises (SMEs) to the economic development of most developing countries is overwhelming and plays a social and political role through employment generation, increasing the standard of living and maintaining a balanced regional development (Mittal & Batra, 2004). SMEs are individually small; collectively they have emerged as a dominant player in Bangladesh economy.

Considering presences of SMEs in Bangladesh economy, it is found that almost 90 per cent of the private enterprises are SMEs and about 70-80 per cent of non-agricultural workforces are working there. The SMEs contributed up to 25 per cent of GDP including about 40 per cent of gross manufacturing output and around 25 per cent of the total labor force (Mintoo, 2007). As Prasad et al. (2001) contend, growing SME will also contribute in expanding the size of the directly productive sector in economy; generating tax revenue for the government; and, all in all, facilitating poverty reduction through fiscal transfers and income from employment and firm ownership.

Comparatively, most SMEs are not registered as corporate bodies but as sole proprietorship this makes registration procedures quite simple and somewhat easier than the other forms of business registration. Partly due to this phenomenon, SMEs has outnumbered all the other forms of business and could be found almost everywhere across the country. In spite of their numbers, and significance, recent studies show that 60% of the SMEs fail within the first five years of operation (Boachie et al., 2005). Studies also show that it is hard for the SMEs to access finances from the financial institutions since they lack proper financial records as a requirement (William, 2008). Detailed accounting records and audit their financial statements on an annual basis will enable the banks to make a proper evaluation of SMEs, which should improve their accessibility to credit (Olufunso et al., 2010). Unfortunately because most SMEs in Bangladesh are managed by owner, they sometimes believe they have less need for financial accounting information because of their personal involvement in the day-to-day operations. This assertion may not be entirely true especially when it has to do with looking for finance.

The study is relevant in the Bangladeshi context given the important role SMEs play in the economic development. There is the need to explore the accounting practices of SMEs in Bangladesh and to ascertain whether they are able to meet the expectations of finance providers. This will improve SMEs access to funds and improve the performance of the general level of economic activity. The study will add to the literature on accounting practices of SMEs and therefore add to a body of knowledge. The study will also have important policy implications for the government of Bangladesh and SMEs in general.

Objective of the Study

The broad objective of this study is to understand the Accounting and Financial Reporting Practices of SMEs in Bangladesh. However, the specific objectives of this study are:

1. To investigate the types of accounting records being kept and maintained by SMEs.
2. To analyze the motivation/ purpose for maintaining accounting records.
3. To find out the reasons for not keeping accounting records.
4. To provide suggestion on how to improve the accounting practices of SMEs.
5. To know the impact of accounting records on firms financial performance.

2 Literature Review

A strand of the literature looks at the importance of accounting systems on the basis of its application in assessing the performance of businesses by all stakeholders. An emphasis is laid on the significance of keeping proper books of accounts by Biryabarema (1998) because it enables small businesses to have accurate information on which to base decisions.

The quality of accounting information utilized within the SME has a positive relationship with an entity's performance and survival (Lybaert, 1998; Kinney, 2001). Similarly, it has been emphasized that there is the need for financial information for small and micro business units due to the volatility normally associated with their situation such as unstable cash and profit positions, and reliance on short-term borrowing (McMahon & Holmes, 1991; Dodge, Fullerton & Robbins, 1994). Kinney (2001) posits that accounting is one of the important types of information for decision making both within and outside the organization. In the words of Osuala (1993), many enterprises record their transactions randomly without adherence to any established systems of accounting; hence making it difficult in keeping track of the cash flows in the enterprises. Mitchel et al. (2000) argued that accounting information could help SMEs manage short-term problems in such areas as costing, expenditure and cash flow by providing information to support monitoring and control. Peren and Grant (2000) noted that decision making processes in small scale enterprises are more sophisticated than anticipated but they lacked effective accounting information and control system to support their decisions. In the process of planning for profit, financial information is assembled in a way that can help make informed judgment and take decisions concerning the organisation (Copeland & Dascher, 1978).

The high rate of failure of small scale enterprises in developing countries like Bangladesh, has generally been traced to poor management and accounting systems employed by these enterprises (Ofonagoro, 1983). In spite of the considerable amount of studies conducted in accounting over the last few decades, there has been little effort on investigating the accounting systems maintained by SMEs and their effectiveness (McChlery et al., 2005).

According to Wichman (1983), accounting is a major challenge to management of SMEs. A study by McMahon (1999) finds that financial reporting practices in SMEs appear to fall short of the standards recommended by various external financial information users imperatives that exist for them, and further claim that SME managers/owners appear mostly reluctant to produce financial reports which might become accessible to outside parties either through the regulatory authorities or directly. The study recommends that SME managers and/or owners need to learn about proper accounting or engage the services of accounting experts for accounting reporting purposes. However, they argue that such accounting reports must be customised to suit the needs of SMEs. There have been proposals that the use of the cash basis must be preferred the accruals basis of accounting.

A study by Lalin and Sabir (2010) concludes that regulations are the main drivers why SMEs prepare financial statements. An early study of users of financial statements in SMEs revealed that owners, managers, tax authorities and lenders are the main users. According to Olson et al. (2004), contemporary studies are discovering that the number of users of accounting information in SMEs is increasing to include venture capitalists and customers in supply-chains. Wichman (1983) concludes that accounting and marketing pose major challenges to management of SMEs and recommends that managers or owners in SMEs must learn about accounting or hire experts. Walhlstedt (1996) believes that conventional accounting reports play a significant role in SMEs but argues that the reports must be adjusted in order for them to be understood, proposing the use of the cash basis rather than the accruals basis.

The existence of practical problems in deriving records and figures that makes up the statements. One reason for that is because for almost all enterprises the owners keep all the records in memory and hence the lack of records of all kinds – sales, marketing, accounting, credit borrowing from lending institutions, staff costs, owners emoluments, etc. Owners of SMEs do not keep proper records and thus, they are not able to provide data about their entities. (McMahon, 1999). Maintaining a proper system and efficiently handling it is always a major challenge. (Amaoke, 2013). The SMEs might not keep the accounting records as it is time consuming and expensive. The enterprises might feel that spending much time and expenses in keeping the records are not that beneficial for them. Another reason for not keeping the record is it requires technical skills and knowledge which is not available for certain causes and if it is available it will involve more expenses because they need to hire more efficient staffs that will have the proper skill and knowledge for maintaining the records. As the proper records will be kept it will definitely expose the financial position of the firm and if it tends to be profitable the enterprise might need to pay more tax. The SMEs might feel there is no need to keep the records for the above reasons and find it difficult to maintain the system. (Amaoke, 2013). The SMEs can organise trainings for the managers and the owners. They can hire consultants for analysing financial statements. They should be aware of the importance of maintaining accounting records and make the use of accounting records mandatory. The manager and owners should be motivated to adopt accounting records. They can be offered free accounting services. The system should have a strong supervision and wisely monitored. The managers and owners should be educated on need to keep accounting records. (Amaoke, 2013).

3 Research Methodology

A sample of 210 entities from SMEs located in Chittagong was chosen in convenience sampling method for the purpose of this study. Each SME represented with one respondent only. Data collection was accomplished by personal delivery. The population of the study consisted of accountant or manager of SMEs. A self-designed questionnaire was used to gather the research data. A total 210 sets of questionnaires were distributed among accountant or managers of SMEs, only 100 useable questionnaires were returned. The questionnaire was divided into three sections. The first section comprised of demographic

characteristic and profile information of the respondents and SMEs. This section consisted of 7 questions which 5 questions were intended to measure entrepreneur and firm characteristics and sixth question that sought to categorise respondents into whether proper books of accounts is maintained or not.

In second section after the categorisation, respondents were separated according to who keeps the record and who doesn't. The respondents who answered "Yes" which was (44) were asked their motivation/purpose for keeping the accounting records.

The respondents who answered "No" which is (56) were asked again whether they maintain any form of records and the reasons and challenges for not keeping the accounting records. Finally all the respondents were asked to provide some suggestions for improving the accounting practices in SMEs. The five-point Likert scale used to measure the extent of agreement or otherwise had 5 as "strongly agree", 4 as "agree", 3 as "uncertain", 2 as "disagree" and 1 as "strongly disagree". In third section, firms were asked to provide financial information about profit and investment where only 32 firms out 100 firms given those information in which 15 firms from 44 firms who keep the accounting records and 17 firms from 56 firms who do not keep the accounting records.

Research Hypothesis:

As per the objectives of the study, the following hypothesis was developed for testing:

H₁: The accounting and financial record has significant impact on financial performance of firms.

So, the hypothesis is:

H₀: The accounting and financial record has no impact on financial performance of firms.

H_A: The accounting and financial record has significant impact on financial performance of firms.

4 Findings and Analysis

4.1 Profile of Respondents

Out of 100 respondents survey 76 (76%) were males and 24 (24%) were Table 1: General characteristics of respondents. The results indicate that more than 46% of the respondents are masters' degree holders, 30% bachelors' degree holders, 22% had professional degree holders and 2% are PhD holders. The respondents were surveyed about the duration of their engagement the profession. The result shows 48% of the respondents are in the profession for below 5 years, 24% of the respondents are between 10-15 years, 16% between 5-10 years, and 12% of the respondents are engaged in the profession for above 15 years.

4.2 Profile of Firms

Our questionnaire captured the profile of firms surveyed in terms of nature of business, ownership structure. On the ownership structure of business, 42% of the firms surveyed were classified as sole proprietorship. Most of these businesses were managed by their owners. 22% were classified as partnership. 36% of the firms were family business which indicates a good amount of business is managed by family. Also, the nature of the business indicated that majority of the businesses surveyed were involved in wholesaling which is 30%. Next follows with a 26% is retailing whereas the service segment follows with 20%. 16% is involved in manufacturing and the rest 8% is in export/import segment.

4.3 Keeping Accounting Records

After taking some general information from the respondents and the firm, the main question was posed: “Does the firm keep accounting records?” This question sought to categorise the respondents. The respondents were provided with two options “yes” or “no”. Out of the 100, 44% respondents answered yes. The “yes” meant that, per their own understanding of accounting records they are in place. The 56% who answered “No” are those whose records, even when they have, do not follow any prescribed manner to make it qualify for a classification under any accounting record.

Table 1: Response on whether the firm maintains accounting records or not (N = 100)

<i>Records</i>	Frequency	Percentage
<i>Yes</i>	44	44%
<i>No</i>	56	56%
<i>Total</i>	100	100%

Those who answered “No” (N=56) were asked whether they kept any form of records for their transactions. Of the 56 respondents, 40 (71.4%) answered that they kept some “informal” notes that guide them to track their debtors but such notes do not follow any order to make it qualify for any form of accounting records. This implies that 28% of those who do not maintain accounting records have no records at all for their transactions. Table 2 has this report.

Table 2: Response on whether the firm maintains any form of records (N =56)

<i>Records</i>	Frequency	Percentage
<i>Yes</i>	40	71.4%
<i>No</i>	16	28.6%
<i>Total</i>	56	100%

4.4 Types of Accounting Records Being Kept and Maintained by SMEs

After establishing that there are 44% of the respondents who do keep accounting records, it is sought to determine what types of accounting records being kept and maintained by SMEs. Table 3 presents the top five rankings are Statement of Cash flow, Bank Statements, Balance Sheet, Statement of cash flow and Statement of change in financial position.

Table 3: Types of accounting records being kept and maintained by SMEs (N =44)

Types of accounting records	N	Mean	Std. Deviation	Rank
Balance Sheet	44	4.1818	.95799	3 rd
Statement of Profit and Loss	44	4.8636	.35125	1 st
Statement of cash flow	44	3.8636	1.42413	4 th
Statement of change in financial position	44	1.8636	1.08213	5 th
Bank statement	44	4.5455	.80043	2 nd
Financial forecasting and budgeting	44	1.2727	.63109	8 th
Financial ratio analysis	44	1.5909	1.00755	6 th
Break even analysis	44	1.3636	.72673	7 th
Cost-volume-profit analysis	44	1.1364	.46756	9 th
Published industries information and trends	44	1.0909	.29424	10 th

4.5 Motivation/Purpose for Maintaining Accounting Records

After establishing that there are close to 56% of the respondents who do not keep accounting records, it is sought to determine what motivates others to maintain accounting records. Table 5 shows that respondents agree that the main purpose for keeping the records is “tracking of receivables and payables”. A larger percentage of respondents agree that it is important to monitor what is accounting records and accounting practices when running a business. Accounting record is important because the firm needs to know about their customers who owe them money and accounting practice is important because they need to know about the amount they owe. The mean and standard deviation for this factor are 3.22 and 1.26 respectively. The other factors that rank high are “to assist in accessing credit/finance” and “performance evaluation purpose” with mean scores 3.14 and 2.86 respectively. The lowest ranked factor among those presented was “determining the size of the business” at 1.12.

Table 4: Motivation/purpose for maintaining accounting records (N = 44)

<i>Motivation/Purpose</i>	Mean	Standard Deviation	Rank
<i>Taxation purpose</i>	2.14	1.23	5 th
<i>Income distribution purpose</i>	2.27	1.26	4 th
<i>Performance evaluation purpose</i>	2.54	1.25	3 rd
<i>Tracking of receivables and payables</i>	3.22	1.26	1 st
<i>For support in accessing credit/finance</i>	3.18	1.33	2 nd
<i>To determine the size of business</i>	1.96	1.12	6 th

4.6 Reasons for Not Keeping Accounting Records

After the respondents have been categorised into two, those who do not keep accounting records were asked to rank a list of eight possible reasons to justify why they do not do that. The results are present in Table 5. Respondents agreed that the main reason for it is that “It is difficult to maintain the system”. It has a mean of 3.75; and standard deviation of 1.10. This means the respondents finds it difficult to maintain the records. Again, this was followed by reasons like “There is no need to keep accounting records” and “It makes your enterprise pay more tax” with mean of 3.25 and 3.17 respectively.

Table 5: Reasons why SMEs do not keep accounting records (N= 56)

	Mean	Standard Deviation	Rank
It is time consuming	2.08	0.82	8 th
It is expensive	2.75	0.86	5 th
It requires technical skills and knowledge	2.25	1.02	7 th
It requires more staffs	2.61	1.03	6 th
It exposes financial position	2.96	0.91	4 th
It makes the enterprise to pay more tax	3.17	0.93	3 rd
There is no need to keep accounting records	3.25	1.09	2 nd
It is difficult to maintain the system	3.75	1.10	1 st

4.7 Suggestions on How to Improve the Accounting Practices of SMEs

On their opinion of what could be done to improve the accounting practices of SMEs, a list of eight suggestions was presented for respondents to rank. The result is presented in Table 6 shows that respondents agree that educating managers and owners on the need to keep accounting records is paramount. This is in agreement with the fact that most of the respondent who do not keep the records are of the opinion that it is of no use to keep them. It also shows the motivating managers/owners to adopt accounting records can be beneficial for the firm and if monitoring and supervision could be strengthened the SMEs will be motivated and efficiently do accounting practices.

Table 6: SMEs opinion on how to improve their accounting practices (N=100)

	Mean	Standard Deviation	Rank
<i>Organise training for managers and owners</i>	1.96	0.79	7 th
<i>Hire consultants for SMEs for financial statement analysis</i>	2.88	0.85	5 th
<i>Make the use of accounting record mandatory</i>	3.06	0.89	4 th
<i>Offer free accountancy service</i>	2.68	0.97	6 th
<i>Motivate managers/owners to adopt accounting records</i>	3.34	0.71	2 nd
<i>Strengthen monitoring and supervision</i>	3.22	0.95	3 rd
<i>Educate managers/owners on the need to keep accounting records</i>	3.66	1.17	1 st

4.8 Hypothesis Testing:

The SPSS outputs of hypothesis-1 (H₁) are following:

Table 7: Group Statistics

Org	N	Mean	Std. Deviation	Std. Error Mean
ROI Firms maintain Accounting and financial records	15	33.5333	3.60291	.93027
ROI Firms do not maintain Accounting and financial records	17	24.9412	2.33106	.56536

Table 8: Independent Samples Test

Levene's Test for Equality of Variances		t-test for Equality of Means						
							95% Confidence Interval of the Difference	
F	Sig.	t	df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	Lower	Upper
3.138	.087	8.105	30	.000	8.59216	1.06013	6.42709	10.75722
		7.893	23.452	.000	8.59216	1.08859	6.34263	10.84168

As a significant difference in the financial performance (ROI) for Firms maintain Accounting and financial records (M=33.53, SD= 3.60) and Firms do not maintain Accounting and financial records (M=24.94, SD= 2.33), $p = .000$. From Table 8, it has been seen that the significant value is less than 0.01. As a result, null hypothesis (H₀) is rejected and alternative hypothesis (H_A) is accepted. These results suggest that firms which maintain Accounting and financial records have an effect on the financial performance (ROI).

5 Recommendations and Conclusions

The study seeks to explore the accounting and financial reporting practices of SMEs in Bangladesh. The results reveal that SMEs do not maintain proper books of accounts because owners find it difficult to maintain the

system and do not appreciate the need to keep accounting records, lack the necessary accounting knowledge and blame the records would make their firm pay more tax. Consequently, the application of accounting information to support assessment of financial performance by SMEs in Bangladesh is inefficient.

Accounting training programmes for SMEs should be initiated by the Ministry responsible for Trade and Industry for those who do not know about the importance of maintaining accounting records to come to grips with it. This strategy will help them to advance their accounting practices and bring about the possibility of formalizing their operations. As critical as accounting information is in managing relationships with the outside world, owners and managers need to understand the role of such information in the form of clear financial statements in ensuring proper justification for business transactions and state of affairs.

We recommend that, as a means of motivation, the authorities should design specific guidelines for SMEs accounting and provide templates for accounting practices of SMEs. This strategy will reduce the technicalities involved in maintaining accounting records and also make the whole process very simple and friendlier.

Since most of the respondents seem not to support attempts of making it mandatory to maintain proper accounting records and subsequently produce final accounts, we recommend that accounting record in SMEs become mandatory. We maintain that proper accounting is paramount in any business and that it is crucial in tracking all aspects of the business from the information contained in the books – as in what is happening in the business, how much has been sold, what the costs are, what activities are profitable, whether selling prices leave a suitable margin against cost and so on.

The government should put in place a regulatory body to ensure that SMEs keep proper books and prepare final accounts. This will not only ensure the proper declaration of income and increase tax revenue to the government but also make available proper data for national income accounting which usually influences major government policies. To the extent that such information is required by business owners and government, the necessary legal instruments and proper monitoring must be in place to ensure compliance.

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