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An Analysis upon Some Accounting Practices of SME: A Review

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Abstract – The study revealed that the majority of the studied firm has no formal accounting practice. The study also revealed that the major sources of finance available for the establishment and expansion of SMEs are personal saving, microfinance, money from friends or relative, iqub and less from banks. The result of ordinary least square regression evidences that

variables such as capital, manager education level and age of the firms are the significant determinants of firms' accounting practices whereas the problems significantly associated with access to bank credits are the demand for collateral, accounting practice or formal accounting information and age of the firm.

There have been the recent calls for additional research in order to enhance the understanding of the adoption of management accounting practices (MAPs) in small and medium sized enterprises (SMEs). This, allied to an increasing importance of SMEs around the world especially in developing countries, is the motivation for this research. This research explores the uptake of a broad range of MAPs in SMEs; identifies the roles of MAPs in the management of SMEs; determines factors that affect the extent of use of MAPs in SMEs and lastly examines the relationship between the use of MAPs and organizational performance of SMEs.

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INTRODUCTION

In order to understand the role of small and medium practices (SMPs) in providing business support to small- and medium-sized enterprises (SMEs),1 it is important to set out the general context within which this key role operates. SMEs are now crucial to most developed and developing economies. For example, in the European Union, SMEs contribute to over 99% of all enterprises and 100 million jobs, representing 67.1% of private sector employment. Extant theory and evidence demonstrates that owners and managers of SMEs utilize external sources of advice and support services primarily because of a gap in their internal resource base. SMEs need to have competencies in order to survive in a changing environment and buying-in resources, in terms of advice and support, is a dominant approach for their survival and development. It is this resource gap and changing environment faced by SMEs that creates a role for SMPs as key business advisers. The type, nature and future of this role is, however, open to question.

From an advice and support demand side perspective, it is widely recognized that SMEs draw upon the service of professional accountants in order to comply with statutory audit and taxation matters. Research also suggests that SMEs draw upon accountants for noncompliance advice, although this aggregate picture masks some variations in takeup between SMEs and the dynamic nature of this market. Indeed, the evidence base shows that accountants are invariably the most frequently used source of advice out of all advice providers, private and public, if not the first choice by SMEs.

Even though compliance requirements vary between different jurisdictions, it is often assumed that the prominence of accountants in SME external relations is universal. How universal such patterns of external advice seeking behavior remains open to question. There will inevitably be variations within the SME population. For example, amongst larger SMEs it is sometimes argued that the resource constraints are relaxed and they do not use external accountants so frequently because they may employ their own accountant and other senior management team members will deal with other strategic and operational issues.

However, the SME market is also very dynamic. The market conditions and regulatory environment within which SMEs are operating is constantly changing and as a corollary, the demand for business advisory services will also be evolving. Government regulatory changes in the requirements for a statutory audit is probably the most pertinent issue, but other factors are also affecting the demand for advice and support such as the need to meet other regulatory requirements as well as coping with threats and opportunities in the marketplace. This presents new challenges and opportunities for the providers of advice and services. Accountants are in a strong position to fulfill the needs of SMEs, but it is important that the advice and services they provide are fit for purpose, that is relevant, timely and of high quality.

SMEs themselves are a heterogeneous group, possessing different size, age, sector, location and growth profiles as well as run by owner-managers with different capabilities and motivations. These characteristics inevitably influence the type of external service provision they will seek. The statutory requirements and regulatory regimes in which SMEs operate have also changed over time. For example, in a number of jurisdictions, whilst there has been a relaxation in the statutory audit provisions, there have been changes in regulation in other areas, such as employment rights and environmental regulations. Despite movements to reduce the regulatory "burden" on SMEs, the market for advice and support is substantial. In the UK, for example, it is estimated that businesses spend at least £1.5bn to help them deal with regulations.

It is into such a dynamic environment and marketplace that accountants, and particularly SMPs, seek to provide advice to businesses. Hence, the market for advice, deriving from regulations that affect SMEs, is constantly changing. Given the change in the market conditions for advice this has led many accountants to enter into providing a wider range of services to SMEs. This has major implications for those accountancy practices seeking to engage with SMEs. Over time, the amount and type of advice from accountants has evolved according to both the needs of SMEs and the strategic intent of accountants.

The accountancy industry has undergone dramatic changes in the provision of statutory, compliance work. For example in the UK the number of registered audit firms has been gradually declining. The overall number of audit firms registered in 2008 (8,179) is 25.7% lower than the number in 2003 (11,006).2 Related to this, in terms of fee income for many accountancy practices, the picture has also changed. For example, in the UK over the past five years, the "Big Four" have experienced a steady increase in the proportion of fee income from non-audit work for non-audit clients. In contrast their fee income from non-audit work to audit clients has been falling.

There are varying worldwide definitions of what constitutes an SME although they tend to use the same metrics of employment, turnover and asset base. For example, the European Union defines a SME made up of enterprises which employ fewer than 250 persons (micro 1–9; small 10–49, medium 50–249) and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro.3 In the USA, the employment size threshold is 500 people, with small firms employing 100 people.

Appropriate accounting information is important for successful management of a business. As a consequence, the effective provision of assistance has come to be viewed as vitally important for improving the accounting and other systems of smaller enterprises in order that SMEs can contribute fully to economic growth, as well as providing owners, directors, employees, local communities and other stakeholders with suitable accounting data.

THEORITICAL BACKGROUND OF SMALL AND MEDIUM-SIZED ENTERPRISES

SMEs are defined as non-subsidiary, independent firms which employ fewer than a given number of employees. This number varies across national statistical systems. The most frequent upper limit is 250 employees, as in the European Union. However, some countries set the limit at 200 employees, while the United States considers SMEs to include firms with fewer than 500 employees. Small firms are generally those with fewer than 50 employees, while micro-enterprises have at most ten, or in some cases five, workers.

Financial assets are also used to define SMEs. In the European Union, SMEs must have an annual turnover of EUR 40 million or less and/or a balance-sheet valuation not exceeding EUR 27 million. SMEs play a major role in economic growth in the OECD area, providing the source for most new jobs. Over 95% of OECD enterprises are SMEs, which account for 60%-70% of employment in most countries. As larger firms downsize and outsource more functions, the weight of SMEs in the economy is increasing. In addition, productivity growth – and consequently economic growth – is strongly influenced by the competition inherent in the birth and death, entry and exit of smaller firms. This process involves high job turnover rates – and churning in labour markets – which is an important part of the competitive process and structural change. Less than one-half of small start-ups survive for more than five years, and only a fraction develop into the core group of high-performance firms which drive industrial innovation and performance.

This underscores the need for governments to reform policies and framework conditions that have a bearing on firm creation and expansion, with a view to optimizing the contributions that these firms can make to growth.

Most SME jobs are in the service sector, which now accounts for two thirds of economic activity and employment in OECD countries. Smaller firms are found particularly in wholesale and retail trade, the hotel and restaurant business, communications and business services, and construction. SMEs also account for a high percentage of manufacturing firms in many OECD countries and provide at least half of OECD manufacturing employment. Smaller firms are increasingly present in technology-intensive industries such as information and communications technology (ICT) and biotechnology.

SMEs predominate in the important strategic business services subsector, including services relating to computer software and information processing, research and development, marketing, business organization and human resource development. Increased outsourcing by major manufacturing firms, combined with new technologies that have allowed SMEs to win market niches, has led to 10% annual growth in these knowledge-based services in recent years. The fact that the average firm size in strategic business services is a fraction of the average size of firms in manufacturing or in the economy as a whole is an indication of the importance of SMEs in this field.

SMEs are becoming more involved in international strategic alliances and joint ventures, both alone and in groups. Larger multinationals are partnering with smaller firms with technological advantages to economise on R&D, minimise the lead time for new products and serve emerging markets. And SMEs are reaching across borders to form international alliances and ventures composed of globalised small firms.

Governments recognise that the size of SMEs often prevents them from going global. A wide range of financial and risk-management services, including insurance, bank guarantees and advice, is available to SME exporters through government export credit and promotion agencies.

Information on foreign markets and export opportunities is disseminated through SME homepages and other electronic means. Support is increasingly provided to help smaller firms participate in foreign exhibitions and trade fairs, prepare marketing tools in foreign languages and circulate advertisements abroad. At the same time, it is crucial that governments do not provide support in such a way as to replace the development of a private market for information services. Governments should focus on the public goods aspects of information.

MSME IN INDIAN PERSPECTIVE

In the Indian context, micro, small and medium enterprises as per the MSME Development Act, 2006 are defined based on their investment in plant and machinery (for manufacturing enterprise) and on equipments for enterprises providing or rendering services. According to the Micro, Small and Medium Enterprises (MSME) Development

Act of 2006, (India) a micro enterprise is where the investment in plant and machinery does not exceed twenty five lakh rupees. A medium enterprise is where the investment in plant and machinery is more than five crore rupees but does not exceed ten crore rupees. A small enterprise is where the investment in plant and machinery is more than twenty five lakh rupees but does not exceed five crore rupees. In the case of the enterprises engaged in providing or rendering of services, as

(a) a micro enterprise is where the investment in equipment does not exceed ten lakh rupees.

(b) a small enterprise is where the investment in equipment is more than ten lakh rupees but does not exceed two crore rupees.

(c) a medium enterprise is where the investment in equipment is more than two crore rupees but does not exceed five crore rupees.

Small Industries Development Organisation (SIDO), Small Scale Industries Board (SSIB), National Small Industries Corporation Ltd. (NSIC), Confederation of Indian Industry (CII), Federation of Indian Chamber of Commerce and Industry (FICCI), PHD Chamber of Commerce and Industry (PHDCCI), Associated Chamber of Commerce and Industry of India (ASSOCHAM), Federation of Indian Exporters Organisation (FIEO), World Association for Small and Medium Enterprises (WASME), Federation of Associations of Small Industries of India (FASII), Consortium of Women Entrepreneurs of India (CWEI), Laghu Udyog Bharti (LUB), Indian Council of Small Industries (ICSI), Indian Institute of Entrepreneurship (IIE), National Institute of Small-Industry Extension Training (NISIET), National Backward Caste Finance Development Corporation, National Institute for Entrepreneurship and Small Business Development (NIESBUD), Small Entrepreneurs Promotion and Training Institute (SEPTI), Small Industries Development Bank of India (SIDBI) etc.

The Government of India and the Small Industries Development Bank of India requested the World Bank to support efforts to remove constraints to SME access to finance (including term financing), and to foster SME development. A Bank project involving funding of US$120 million for SME financing and development was subsequently developed. The Project was approved on November 30, 2004, and became effective on April 4, 2005 and is currently scheduled to close on June 30, 2009. The objective of the Project was to improve SME access to finance and business development services, thereby fostering SME growth, competitiveness and employment. The Small and Medium Enterprises Financing and Development Project has been designed to improve access to finance for SMEs. The lending from the original project covered 927 SMEs spread across 10 Indian states.

ACCOUNTING SYSTEMS

In small enterprises there can be different kinds of accounting systems such as external, internal and tax accounting. Annex 3 summarizes data per Member State concerning accounting system requirements for small enterprises. On the basis of this data, the following descriptions of accounting systems are given:

1. Internal accounting – Internal accounting, also called management accounting is based on the enterprise's internal accounting procedures and recorded accounting information. Internal accounting is intended for managers within organizations, to provide them with the economic basis to make informed business decisions that would allow them to be better equipped in their management and control functions. For example, managers may want to be able to assess the contribution or the profitability of different products or services that they supply by comparing the revenues and costs that they generate. Unlike external accounting information, internal accounting is usually confidential and it is accessible only to the management. In most cases, small enterprises do not use internal accounting at all due to their size. Internal accounting is normally not governed by national legislation. However, in some Member States internal accounting is compulsory even for small enterprises.

2. External accounting – External accounting, also called financial accounting is concerned with the preparation of financial statements for decision makers, such as the owners, suppliers, banks, governments and its agencies, customers and other stakeholders outside the enterprise. Regarding formats for financial statements. External accounting makes use of the accounting information from the internal accounting system. In the preparation of the external accounting, the small enterprise may be governed by local GAAP. Some Member States have introduced external accounting rules for small enterprises, while others have no accounting rules in place and leave it to the enterprises themselves to decide which accounting systems they consider to be appropriate for their particular circumstances and business environment.

3. Tax accounting – Tax accounting is normally based on the external/financial accounting system. There may be differences between the profits for tax purposes and the profits per the accounts. Tax authorities often ask for additional adjustments to be made to the profits per the accounts and these are captured in a "tax computation". Some examples of adjustments which are quite common between profits per accounts and tax profits:

- Depreciation differences
- Accruals
- Expenses which are disallowed for tax purposes
- Non-taxable income

In some Member States, taxation is carried out on a cash basis accounting system, in which case further adjustments (when the enterprise uses accrual basis accounting) like accruals, unrealised income and unrealised expenses are to be made to the enterprise's results before the tax computation.

The accounting framework lays down the concepts and principles that are the basis for preparing and presenting the external financial statements of an enterprise. These principles may not necessarily be applicable in all Member States to all enterprises all the time because of e.g. the size of the enterprise or different user's needs. Therefore, each enterprise needs to decide which principles it considers most important and applicable to its particular circumstances and business environment.

GOOD ACCOUNTING PRACTICES

Considering the described accounting systems from the point of view of small enterprises, the following good practices are provided for the improvement of the accounting systems for small enterprises. The aim is not to add to regulation or administrative burdens. The "Think Small First" principle has been considered when identifying the good practices. It should be noted that these good practices are in no way intended to encroach upon the sovereignty of Member States in accounting matters.

Users and their needs - For small enterprises it is especially burdensome to supply financial information to many different users/stakeholders, therefore administrative simplification in the supplying of financial information to different or the same authorities for different or the same purposes should be implemented as far as possible, meaning that the information should be supplied only once i.e. the "only-once principle". Therefore Member States are encouraged to promote the use of e-government portals. For this purpose there are already some tools/taxonomy e.g. XBRL (eXtensible Business Reporting Language) available in the market.

Applying the "only-once principle" in accounting issues means that:

1. During one and the same accounting period, enterprises do not have to provide the same

financial information to the Member State or to its various bodies more than once;

2. Without prejudice to any necessary updating, enterprises are not obliged to provide the Member State with information that is already received by any other route and that

Some Member States have projects to implement on-line financial reporting for small enterprises using the XBRL as a basis as a user friendly format.

Financial statements - Small enterprises may use simplified formats for financial statements i.e. for the balance sheet and the profit and loss account. Depending on the business environment in which the enterprise operates, it can choose the format of the profit and loss account i.e. by nature or by function. Normally the financial statements would be prepared once a year when the tax declaration has to be provided.

A projected cash flow statement can be very useful for small enterprises because the cash management of a small enterprise is especially important. Cash flow projections are partly based on information from the accounting systems of the enterprise. Cash management becomes especially important in situations when the economy is heading for a downturn.

To help speed up and professionalize negotiating loans, it is useful to agree on binding standards about form and contents of information provided between SME-organizations and banks. Small enterprises and banks gain transparency about the scope and the quality of the information. The bank guarantees a decision within a short period. (e.g. 10 days). The SME-organization may offer support to the small enterprise in the preparation of the records and the negotiations.

APPLICABILITY OF ACCOUNTING STANDARDS

The Institute of Chartered Accountants of India (ICAI) have notified in October 2003 certain relaxation in applicability of accounting standards after due consideration of the representations from industry and profession. The relaxations have been guided by the Small and Medium sized Enterprises (SMEs)/ non-corporate assessees level of preparedness and cost benefit analysis of Accounting Standards compliance in case of reporting and disclosure standards. The accounting standards applicability has been revised as under in respect of accounting periods commencing on or after 01.04.2004. For the purpose of applicability of accounting standards, enterprises are classified into three categories-

- Level -I enterprise

- Level-II enterprise

- Level-III enterprise

Level –I enterprise- Enterprises which fall in any one or more of the following categories, at any time during the accounting period, are classified as Level-I enterprises:

- Enterprise whose equity or debt securities are listed whether in India or outside India.
- Enterprises, which are in the process of listing their equity or debt securities as evidenced by the board of directors' resolution in this regard.
- Banks including co-operative banks.
- Financial institutions.
- Enterprises carrying on insurance business
- All commercial, industrial and business reporting enterprises, whose turnover for the immediately preceding accounting period on the basis of audited financial statements exceeds Rs. 50 crores. Turnover does not include 'other income'.
- All commercial, industrial and business reporting enterprise having borrowings, including public deposits, in excess of Rs. 10 crores at any time during the accounting period.
- Holding and subsidiary enterprise of any one of the above at any time during the accounting period.

Level-II Enterprise- Enterprises, which are not Level-I enterprises but fall in any one or more of the following categories, are classified as Level-II enterprises:

- All commercial, industrial and business reporting enterprises, whose turnover for the immediately preceding accounting period on the basis of audited financial statements exceeds Rs. 40 lakhs but does not exceed Rs. 50 crores. Turnover does not include 'other income'.
- All commercial, industrial and business reporting enterprises having borrowings, including public deposits, in excess of Rs. 1 crore but not in excess of Rs. 10 crores at any time during the accounting period.

Level-III enterprise- Enterprises, which are not covered under Level-I and Level- II, are considered as Level-III enterprises.

CONCLUSION

SMEs have been fully recognized by governments and development experts as the main engine of economic growth and a major factor in promoting private sector development and partnership. The development of the SME sector therefore represents an essential element in the growth strategy of most economies and holds particular significance in the case of Nigeria. SMEs not only contribute to improved living standards, employment generation and poverty reduction but they also bring about substantial domestic capital and achieve high levels of productivity. From a planning standpoint, SMEs are increasingly recognized as the principal means for achieving equitable and sustainable industrial diversification and growth.

This study is limited to small and medium-sized accounting agencies for which some adoption factors, assumed to be relevant in this context, are tested. There is a danger that additional significant factors have not been included in the study, and any comments and suggestions for further improvements on this ongoing research project are very welcome.

The accounting systems in place for small enterprises in Member States vary a lot. There are cases when there are no accounting requirements at all and cases where the accounting requirements are relatively strict for small enterprises. However, in practical terms, all small enterprises will need to keep some kind of financial records in order to keep financial control over their businesses. This report summarises the likely accounting systems from the point of view of small enterprises in Member States and identifies some good practices on how to improve the accounting systems for small enterprises.

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