

A Study of impact of accounting record keeping practices on financial performance of SMEs – Evidence from Badulla District Sri Lanka

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Introduction

Accounting practice refers to the ordinary, practical application of accounting and or auditing policies that occur within a business (European Commission, 2008). The American Institute of Certified Public Accountants defines accounting record keeping as the analysis, classification and recording of financial transactions in books of accounts to permit informed judgment and decision making by the users of the information. SMEs play important roles in the economic growth and sustainable development of every nation (Maseko and Manyani, 2011). Failure to record business transactions (bookkeeping) leads to collapsing of the business within few month of its establishment (Muchira, 2007). It has been recognized that appropriate accounting information is important for a successful management of any business entity, whether large or small (European Commission, 2008). One of the reasons for failure of SMEs is not having proper accounting practices (David and Thomas, n.d.; Ramawickrama, 2011; Scovia, 1998). In other words there is a direct relationship between book keeping and financial performance. Therefore, poor book keeping would lead to poor financial performance and proper book keeping would lead to better financial performance of the SMEs. As such there is need for the owners and managers of the SMEs to embrace proper book keeping practices in order to be successful in their financial performance (David and Thomas, n.d.).

There were only few studies conducted in Sri Lankan with regard to the accounting recordkeeping of Sri Lankan SMEs and financial performance (Karunandna and Jayamaha, n.d.). Accordingly, the first objective was to identify the relationship between accounting record keeping practices and financial performance of the SMEs and second objective was to identify the challenges SME owners face in their record keeping in SMEs.

Methodology

The population of this study was SMEs which have got registered in Chamber of Commerce in Badulla District Sri Lanka. Only 50 SMEs was used to collect data. The convenience sampling technique was used for the purpose of the research by covering the Divisional Secretariats of Badulla district. Structured questionnaire was used to collect quantitative data and further few focus group discussions were carried out to confirm the results. Descriptive statistics, Pearson correlation coefficient and multiple linear regressions were used to analyze quantitative data. The analyzed data were presented using tables and graphs. In addition, Cronbach Alpha reliability test was employed to assess the validity of the questionnaire and it was 0.77. The financial accounting practices measure by using accounting system (AS), accounting principles (AP), accounting transactions (AT), double entry bookkeeping (DE), use of accounting formats (AF), financial statements (CFS). Sales growth (SG) used to measure financial performance.

Results and Discussion

According to Table 1 Pearson Correlation Coefficient analysis the accounting system and principles have negative relationship with financial performance and other four dimensions were having positive relationship. All the correlations were significant at 0.05 levels.

Table 01: Pearson Correlation Coefficient Analysis of Variables

Variables	AS	AP	AT	DE	AF	CFS
Pearson correlation coefficient	-0.284	-0.477	0.455	0.459	0.426	0.547
Sig	0.023	0.000	0.000	0.000	0.001	0.000

There were negative relationships between financial performance and accounting systems and accounting principles. SMEs were not paying more attention on preparing budgets, variance analysis, cost statements, share financial information with third parties and Using cash basis, accrual basis and taking previous period ending balance as opening balance of present period were accounting principles used for keeping financial records.

The regression formula of the study was, $FP = -0.772 + (-0.340 AS) + (-0.263AP) + 0.662AT + 0.303DE + 0.280AF + 0.438CFS + \epsilon$. In accordance with the regression equation the constant value is -0.772 . The value of Adjusted R Square was 0.663 which implies that 66% of the variation in firm performance could be explained by the changes in financial statements, accounting principles, format of an account, accounting system, double entry, financial records. This value indicates that 66% of the variance in financial performance can be predicted from the variables in financial statements, accounting principles, format of an account, accounting system, double entries and financial records. The model being significant at 0.05 confidence level indicates that the independent variables of this study which are financial statements, accounting principles, format of an account, accounting system, double entry, financial records greatly contribute to the variation in financial performance.

Table02: Challenges faced by SMEs in record keeping

Challenges	Frequency	Percent
Lack of Accounting Knowledge	16	32.0
Cost and Time Constraints	8	16.0
Lack of Guiding Accounting Rules	22	44.0
Poor Management	2	4.0
Negative Perception about Accounting Practices	2	4.0

The Table 2 express 44% of SMEs were facing the challenge of lack of guidance about the accounting record keeping. Majority of the SME owners did not have proper knowledge about the accounting record keeping and accounted to 32% of the study. Firms were using practices built on

their own. The reason for this is SMEs not having proper knowledge about the accounting practices. Furthermore firms believed that accounting record keeping was an additional cost for the firm and it was a time consuming activity. Due to this SMEs are facing problems in providing information to other parties. And it badly affected to the firm as well. Because of that to obtain funds to the firm SMEs did not have proper records to prove the performance of the firm. In this study it is implied by 16% SMEs suffering cost and time constraints when keeping financial records.

Conclusions

The accounting record keeping practices that have negative relationship with financial performance was consists with accounting system and accounting principle. It can be concluded that for the increase of financial performance was not influenced by accounting system and accounting principles. There was weak positive relationship between financial performance and double entry, financial record and format of an account. SMEs were used sales day book, purchase day book, cash book, petty cash book, bank transaction book, debit book, credit book and salary records for keep the transaction occurred in the firm. Majority of SMEs were used financial statements for financial decision making in the firm and investments decisions of the firm. It was emphasized that financial statements were highly impact on the increase of firm performance. In the regression analysis 66% of the variance in financial performance can be predicted from the variables in financial statements, accounting principles, format of an account, accounting system, double entry, financial records and model was significant at 0.05 levels. In the other words poor record keeping practices would lead to poor firm performance of SMEs. The first objective of the study was proved from this study; there was direct relationship between accounting record keeping practices and financial performance of the SMEs. Due to lack of knowledge about the accounting record keeping practices SMEs were suffer from the decision making. Moreover lack of guiding about accounting practices causes to create a gap of accounting knowledge of SMEs owners. On that basis they willing to used accounting practices developed by themselves. It will significantly influence on the financial performance in various ways. Due to use of own developed practices creates problems on comparing financial information of firms and presenting of financial information. Considering about the second objective mainly identified challenges were lack of guiding accounting rules, lack of accounting knowledge and cost and time constraints.

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