Relationships between accounting practices and financial strengths of SMEs: reflections from financial and accounting experts

Supanee Injun

Faculty of Management Science, Nakhon Pathom Rajabhat University,
Nakhon Pathom 73000, Thailand

Abstract

This research aimed to identify the accounting practices favoured by SMEs and the relationships between accounting practices and financial strengths of SMEs. Four accounting practices: Inventory Valuation, Depreciation, Income Realization, and Report Processing; and 4 group of financial ratios, as the indicators of their financial strengths: Liquidity, Efficiency, Profitability, and Leverage were included in the framework. A Likert scale questionnaire was constructed upon the results of the literature reviews and mailed to the purposely selected 20 experts in accounting and finance to express their levels of agreement to the contents. All 20 experts responded to the questionnaire and all the responses were fit for the analysis. Findings mainly reflected accounting practices that were favoured by SMEs and the patterns of the relationships between the accounting practices and the financial ratios of SMEs mutually agreed between these experts. Measures to help promote the accuracy and usefulness of accounting for SMEs and further research with the entrepreneurs were suggested upon the findings.

1. Introduction

This research intended to identify the accounting practices favoured by SMEs and the relationships between accounting practices and financial strengths in SMEs from the current opinion of some selected accounting and financial experts. SMEs had been observed as the backbone of a country's economy [1]. Therefore efforts to help support SMEs should be in the highest priority for the related government agencies and academic institutions.

SMEs in Thailand lacked adequate-skilled personnel on accounting, both employees and the owner [2]. Thus, SMEs in Thailand tended not to prepare their own financial statement but to have a private accounting firm prepared all the report form them [3]. SMEs usually would access to the reports sometime after the ending of the accounting period; the reposts were not used as a part of the business decision [4]. Accounting practices in SMEs seemed to be not up to standard and the owners used financial information not for management but only for tax office and banks [5]. SMEs in Thailand used unqualified accounting information which was untrue, unfair, and non-verifiable; no accounting record; of no compliance with accounting standards and international accepted principles; lack of good accounting information system and good corporative governance [6].

In the international level, there were numerous indications that the owners of SMEs usually paid not much effort into their accounting system despite federal encouragement and the loud preachment from the academics [7, 8]. The governing body of accounting in any country faces varous forms of accounting frauds in SMEs in spite of the extensive promulgation of the wholesome accounting system and its merits. Academics continually advocate the advantage of the relationships between the sound accounting system and financial strength, including liquidity, efficiency, profitability and leverage, but the unawareness persists.

In the year 2016 the Thai Government initiated a measure to help solve the problems by announcing a program for SMEs to start a new phase of sound accounting practises, the commonly called "The One Book Scheme". This program encouraged SMEs to maintain only one set of accounts and financial reports and it was believed to be beneficial for both the operation of SMEs and the Revenue Department [7]. The incentives used in this program included the waive of some current taxes and the omission of the investigation into the whole past of the tax submission. The success of this program was not so promising, as many supports and encouragements for SMEs from the Government had been offered but not much change occurred.

It was challenging to investigate the difficulties of SMEs generally at the whole operation and particularly at the accounting practices. Findings from this investigation would shred some light on the problems of

*Corresponding author; e-mail: supanee_injun@hotmail.com

Table 1 Profiles of the experts

Working Status	Years of Experience & Number of Experts					
	<5	5-10	11-15	16-20	>20	Total
Lecturer of Finance	1	1	-	1	2	5
Lecturer of Accounting	2	3	1	-	1	7
Lecturer of Finance/Auditor of Accounting	-	-	1	-	-	1
Lecturer/Auditor of Accounting	-	1	-	2	2	5
Accountant	-	1	-	-	1	2
Total	**3**	**6**	**2**	**3**	**6**	**20**

Table 2 Inventory valuation methods and related practices favoured by SMEs

Accounting Practice	Median	Inter-quartile Range
1. SMEs usually used 3 methods of inventory valuation: FiFo, Weighted-average, and Specific Value.	4	1
2. Method to valuate inventory must confines to the characteristic of the inventory.	5	1
3. SMEs chose inventory valuation method that was suggested by the official from the Revenue Office.	4	1
4. SMEs chose inventory valuation method that was suggested by the private accounting firm providing report preparation.	4	1

inefficiency and tax frauds and measures to eliminate the difficulties and problems. That would be beneficial to SMEs, related Government offices, and academic institutions.

2. Research objectives

2.1 To identify the accounting practices that are favoured by SMEs and the reasons for the choices.

2.2 To identify the accounting methods in these 4 areas (Inventory Valuation, Depreciation, Income Realization, Financial Report Processing) that are related to the financial strength (As depicted by 4 groups of financial ratios: Liquidity, Operation Efficiency, Profitability, Leverage).

3. Materials and methods

This was a small-scaled survey of the academicians in accounting and finance community. Distinct merits of academicsø viewpoint, in comparison to the practitioners, were the goal to identify generalizable rules that lead to probabilistic predictions [8] and the interest in theoretical pursuit [9]. The researcher reviewed the existing questionnaire related to accounting practices and financial ratios in SMEs and drafted the first version set

of questions. The draft then was criticized by 3 colleague researchers with 3 different expertises: research, accounting, and small business administration; amend-ments and improvements were made. The method of data collection was post mailing, after the direct explanation by telephone with the experts. The experts to be included in the survey must be an academicians or a practitioners in financial and accounting field, with longer than 5 year-experience. The planned number of experts was 21, which to be personally liaised and purposively selected to ensure the enthusiastic and detailed response. The responses for each item in the rating- scaled questionnaire would be analyzed with percentage, standard deviation, median, and quartile [10, 11]. The practices in the questionnaire items to be included in the objectives were the item with its inter-quartile range of 1 or less and its standard deviation of 1 or less.

4. Results and discussion

There were 20 sets of questionnaire returned. The experts were academicians/practitioners, brief profile of the experts was in Table 1.

Table 3 Inventory valuation methods exhibiting relationships with financial strengths

Inventory Valuation Method and the Relationships	Median	Inter-quartile Range
1. In a normal economic situation, with inflation, SMEs that used the method of FiFo would gain higher value of inventory than the actual value.	4	1
2. In a normal economic situation, with inflation, SMEs that used the method of Specific Value would gain the opposite value of inventory to the actual one.	4	1
3. Different inventory valuation methods used in SMEs affected the Liquidity Ratios.	4	0
4. Different inventory valuation methods used in SMEs affected the Profitability Ratios.	4	0
5. Different inventory valuation methods used in SMEs affected the Operating Efficiency Ratios.	4	0.5

Table 4 Depreciation calculation methods favoured by SMEs

Accounting Practice	Median	Standard Deviation	Inter-quartile Range
1. SMEs usually used 5 methods of depreciation calculation: Straight Line, Double Declining, Sum-of-the-year Digit, Unit of Production, Time of Production.	4	0.9333	1
2. Method to calculate depreciation must confines to the characteristic of the assets.	4.5	0.5130	1
3. Method to calculated depreciation must confines to the utilization patterns of the assets.	4	0.5871	1
4. SMEs chose depreciation calculation method that was suggested by the private accounting firm providing report preparation.	4	0.6708	1
5. SMEs chose depreciation calculation method that was easy to calculate even it was not confined to the utilization patterns.	4	0.9881	1

Table 5 Depreciation calculation methods exhibiting relationships to financial strengths

Accounting Practice	Median	Standard Deviation	Inter-quartile Range
1. Different methods of depreciation calculation affected the Liquidity Ratios.	4	0.9105	1
2. Different methods of depreciation calculation affected the Profitability Ratios.	4	0.6048	0
3. Different methods of depreciation calculation affected the Operating Efficiency Ratios.	4	0.7864	1
4. Different methods of depreciation calculation affected the Leverage Ratios.	4	0.9947	1

Findings in each of the 4 areas of accounting practices are presented in accordance with the research objectives, respectively: Accounting practices that were favoured by SMEs, Accounting methods that were related to financial strength. In order to stress the distinguished points of findings, only the items with their inter-quantile ranges and their standard deviation of 1 or less are mentioned in this article.

Table 6 Realization of income methods exhibiting relationships with financial strengths

Accounting Practice	Median	Standard Deviation	Inter-quartile Range
1. Different methods of income realization affected the Profitability Ratios.	4	0.6213	0.75
2. Different methods of income realization affected the Operating Efficiency Ratios.	4	0.7647	0
3. Different methods of income realization affected the Leverage Ratios.	4	0.6578	0

Table 7 Methods of financial report processing favoured by SMEs

Accounting Practice	Median	Standard Deviation	Inter-quartile Range
1. SMEs usually used methods of financial report processing as suggested by the private firm that provided this service.	4	0.6213	0
2. An important reason the SMEs would not process the financial reports in-house was that SMEs did not have any knowledge or expertise on the accounting regulations.	4	0.7873	1
3. SMEs that contracted a private firm for financial report processing would prepared their own financial reports as well.	4	0.8951	0.75
4. Even SMEs that registered in the ‟Single Book Scheme”, they would prepared their own financial reports as well.	4	0.5993	1

4.1 The Valuation of Inventory

(1) Inventory Valuation Methods Favoured by SMEs

The experts jointly agreed that there were some methods of inventory evaluation and some related practices commonly used by SME as showned in Table 2. This practices was in accordance with the literature review of using service from private accounting firm [4].

(2) Inventory Valuation Methods Related to Financial Strengths The experts jointly agreed that some inventory valuation methods exhibited relationships with financial ratios, these methods and the ratios were shown in Table 3. The relationships indicated the necessity for SMEs to improve their financial information system [6].

4.2 The Calculation of Depreciation

(1) Depreciation Calculation Methods Favoured by SMEs The experts jointly agreed that there were some methods of depreciation calculation and some related practices commonly used by SME [4] as showned in Table 4.

(2) Depreciation Calculation Methods Related to Financial Strengths The experts jointly agreed that there was some depreciation calculation methods exhibited relationships with financial ratios, [6] these methods and the ratios were shown in Table 5.

4.3 The Realization of Income

(1) Realization of Income Methods Favoured by SMEs The experts jointly indicated that there was no favourite method of income realization for SME. This indicated the non-verifiable accounting system of SMEs [6].

(2) Realization of Income Methods Exhibiting Relationships with Financial Strengths The experts jointly agreed that some income realization methods exhibited relationships with financial ratios, these methods, [6] the ratios were shown in Table 6.

4.4 The Processing of Financial Report There were 2 methods for SMEs to process the financial reports, namely: In-house Processing and Contracted Service Processing.

(1) Methods of Financial Report Processing Favoured by SMEs The experts jointly agreed that there were some methods of financial report processing and some related practices commonly used by SMEs, [4] as showned in Table 7

(2) Methods of Financial Report Processing Exhibiting Relationships with Financial Strengths The experts jointly agreed that was NOT any methods of financial report processing exhibiting relationships with financial ratios.

5. Conclusions

The experts had pinpointed the accounting methods and the relating practices commonly used by SMEs in 4 areas. However, only 3 areas of accounting methods: Inventory Valuation, Depreciation Calculation, Income Realization, were indicated as exhibiting relationships with the 4 groups of financial ratios, except for the methods of financial report processing, the experts indicated no relationship with the financial ratio. It was noted that there were experts on accounting and finance but no expert on SMEs was included in the sampling plan, therefore several points specific to SMEs were responded as –Not certainø

These findings suggested that SMEs must be further informed of the appropriate accounting methods for their operation. The related Government offices and academic institutions should provide proper knowledge or training to SMEs. As this research was intended to be the first stepping stone for the next research with the entrepreneurs as the population, further research should focus on the reasons behind the problem that SMEs still practicing improper accounting methods in spite of various supports that the related Government offices had provided continually for a long time up to these days.

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