Accounting Practices of Small and Medium Enterprises: A Comparison between India and Kenya

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Abstract: Small and medium Enterprises (SMEs) not only make up the overwhelming majority of the number of businesses but also make a substantial contribution to employment and gross domestic product (GDP) of any country. This paper is an attempt to analyze the accounting practices of selected SMEs both from India and from Kenya to identify the problems faced by SMEs and come up with some workable measures. Because of their vital role both in terms of employment and in terms of contribution to national income, SMEs sector has drawn considerable attention of regulators and policy makers across the globe. Governments have taken a number of promotional measures to recognize the critical importance of SMEs and provide them with enabling environment for faster growth. Despite, accounting for SMEs, an important aspect, which is crucial for the success of any enterprise, has been overlooked for long. Accounting standards so far have been promulgated with the needs of financial analysts and stakeholders of public traded companies in mind. The cost of providing information required under full IFRS (IAS) has prevented many SMEs from adopting their accounting standards.

Key words: Accounting practices, policies and application of accounting standards by SMEs

Introduction

Small and medium enterprises (SMEs) providing a wide range of goods and services worldwide, contribute to economic development in multiple ways and create employment for expanding rural and urban workforce (UNIDO, 2002). In many cases existence of domestic supporting industries especially SMEs have been an attraction for foreign direct investment as a large transitional corporations seek domestic suppliers for their chains. SMEs typically employ between 10 and 250 workers are crucial engines of development through their roles as seedbeds of innovation and form the backbone of modern economies (Ferranti and Anthony, 2007).

The definition of SMEs differs from one jurisdiction to other and maybe based on number of employees, investment in assets or annual turnover. Further the criterion used for classification being the same, the magnitude may be significantly different, for example, in India an enterprise is classified as small if investment in plant and machinery is between 2.5 million to 50 million and medium if investment in plant and machinery is more than 50 million but not exceeding 100 million rupees. (The corresponding limit for service enterprises are rupees 1million to 20 million and exceeding rupees 20 million but not 50 million). Enterprises having less investment than described above are classified as micro enterprises. In Kenya an enterprise, having up to 5 employees is classified as micro-enterprise, that having 6 to 30 employees is classified as small enterprises and the enterprise having 31 to 100 employees is classified as medium enterprise (MTI, 2007). However, for the purpose of proposed international financial reporting standard (IFRS) on accounting for small and medium-sized entities, international accounting standards board (IASB) defines SMEs as an entity having no public accountability regardless of its size. Furthermore the public accountability is defines as raising funds from public markets or holding assets in fiduciary capacity for outsiders (IASB, 2007).

Problem Statement

In a globalized world SMEs have a vital role to play as they provide crucial inputs to majority of transnational corporations (TNCs).their relationship with TNCs up to a large extent depends on the

quality and reliability of information provided by them. Various stakeholders depend heavily on financial information provided by SMEs mainly through financial statements for the purpose of making financial or other decisions. In order to facilitate such decision-making it's imperative that the information is compiled and processed using acceptable and common rules and procedures. However, as it is revealed, SMEs across the world use a variety of accounting practices rendering incomparability to the information so processed and making it least useful for economic decisions thus it provides a perfect setting for comparison between accounting practices of selected SMEs both from India and Kenya.

What is an SME?

"SME" stands for small and medium-sized enterprises – as defined in EU law: EU recommendation 2003/361

The main factors determining whether a company is an SME are:

Number of employees and

Either turnover or balance sheet total.

Small and Medium-sized Enterprises are defined as enterprises which:

Company category	Employees	Turnover or	Balance sheet total
Medium-sized	< 250	≤ € 50 m	≤ € 43 m
Small	< 50	≤ € 10 m	≤ € 10 m
Micro	< 10	≤ € 2 m	≤ € 2 m

These ceilings apply to the figures for individual firms only. A firm which is part of larger grouping may need to include employee/turnover/balance sheet data from that grouping too.

Literature Review

The cost of providing information required under full IFRS (IAS) cost many SMEs providing information that is either not needed or not used by the users of their financial statements and precluded them from providing other useful information (AAICPA, 1981). A survey conducted by Nair and Rotenberg, 1983) reveal that users of small business financial statements rely less on financial statements than do users of large business financial statements. Benson, (1985) concluded that bankers have different information needs for small private companies than for large public companies. This concludes that the financial statements of small companies were perceived to be less reliable by banks and suggested that different measurements and disclosure should be permitted by such small companies. According to GoranMilovanoviæ, (2005) majority of the owners of small and medium enterprises is not experts at accounting and finance and their knowledge of computer technology are poor. Accounting evidence reports are very often prepared for satisfying requirements of governmental agencies only and as a result managers cannot always base their business decisions on such accounting registers.

Research conducted at Sheffield University Management School critically evaluated the limitations of using financial limitations to access the performance of SMEs. Return on capital employed (ROCE) was found to be particularly poor indicator of performance in case of SMEs (Hughes, et al, 2007). Venturelli and Pilisi (2005) studied a sample of SMEs and identified that sample units had no system of measuring and analyzing environmental costs.

In the small and medium sector, the relationship between budgets and strategic planning is not yet understood. SME focus lack depth, and the time horizon chosen is too short especially in relation to capital expenditure budgets (Edward and Turnbull, 1994). The underlying reason is the lack of meaningful financial information on SMEs as many of them do not keep proper financial records and accounts for (Fobara and Ukpai, 2001) one major reason for many SMEs not keeping proper financial records is due to the fact that existing international and some national accounting and reporting requirements of large, listed companies. In most economies, the SME sector is the least well placed to implement those requirements (UNCTAD, 2000). In a survey conducted in Kenya, nearly half of respondents opined that they lacked useful information for decision-making (Paliwal, 2008). SMEs in Cyprus, for the most part, did not follow scientific evaluation techniques for their investment project probably due to lack of familiarity with such methods (Lazzaridis and Lyroudi, 2001, 2004).

Hicks (1999) found smaller businesses adding ANBC to their management tools and recognizing it was a powerful aid as large corporations did. Similarly if implemented properly, cost accounting would be a good aid for decision making and planning in order to improve profitability of small scale businesses Ukpai, (1997).

IASB Effort

Fortunately, IASB has recently taken up a project and is finally at the process of finalizing an accounting standard for SMEs, which once finalized will be a stand-alone document for typical SMEs with about 50 employees with no mandatory fall back to IFRS. The aim of the proposed standard is to provide a simplified, self-contained set of accounting principles that is appropriate for smaller unlisted companies by removing choices for accounting treatments, eliminating topics that are not generally relevant to SMEs and simplifying methods of recognition and measurement. It is also aimed to modify the provisions of existing standards based on users' needs and the cost benefit considerations. IASB expects that the proposed standard would reduce the volume of accounting guidance, applicable to SMEs by more than 85% when compared with the full set of IFRSs and allow investors for the first time to compare SMEs financial performance across international boundaries on a like for like basis. Included in the main objective of the proposed standard, is to ensure that the IFRS for SMEs results in general purpose financial statements on which an auditor can give an option as to fair presentation (or true and fair view) of financial position, performance and cash flows.

The proposed IFRS for SMEs is designed to produce general purpose financial statements that are useful for economic decision making by a broad range of resource providers to SMEs, such as non-manager owner, lenders, vendors and other creditors, customers and employee s. another benefit would be to reduce financial reporting burden on SMEs in those jurisdictions where at the moment, standards designed for reporting by participants in public capital markets have been pushed down to SMEs.

The purpose of proposed IFRS for SMEs is not to provide information to owner managers to help them run their business as they are already in a position to obtain whatever information they need rather it focuses to provide information to outsiders. However, the focus of this paper includes the needs of owner, managers as well as to reveal whether the information they have is comparable with that received by their counterparts from large enterprises as far as its usefulness for decision-making is concerned.

Methodology

Objectives

- To identify the applicability of IASB standards in SMEs in sample units.
- To identify accounting practices in India vis-a vis Kenya regarding SMEs.
- To study present position of the sample units.
- To identify the problems faced by SMEs in applying accounting tools and suggest way to improve quality of accounting information to SMEs.

Hypothesis

- H1.There is no difference in accounting practices followed by SMEs in India and Kenya.
- H2.Lack of knowledge of computer technology of SMEs Owners is a hindrance/obstacles in application of IASB standards / accounting policies.

Scope

The study is based on selected small and medium enterprise both from Udaipur, India and from Nairobi, Kenya, between the periods of 2008 - 2012. The survey also includes other stakeholders such as banks and practicing accountants. Primary data has been collected using questionnaires administered on 50 randomly selected SMEs.

Data Collected and Analysis

The study is based on both primary and secondary data collected from various sources including literature survey, questionnaires and unstructured interviews with the managers and owners of select SMEs and other stakeholders. Despite the shortage of time and other constraints, the response rate 84% was quite encouraging. The respondents include 14 service enterprises, 13 from Kenya and 1 from

India and 28 trading and manufacturing enterprises (9 from Kenya and 19 from India). Analytical tools including graphs, tables, measures of central tendency, Chi-square, ANNOVA etc have been used wherever found appropriate.

Findings and Solutions

As mentioned earlier a survey was conducted to gather primary data about the accounting practices of SMEs from both the countries. Based on survey the section below provides the main findings followed by suggestions.

Profile of Sample Units

To give an idea about the respondents, profile of sample units is summarized in table 1. It is evident that out of 42 active respondents 25 are sole traders. Six are partnerships and 11 belong to other forms of organizations. The sample from Kenya includes 59% service enterprises and remaining represents trading and manufacturing enterprises. On the other hand, 95% of the SMEs in the sample from India belong to trading and manufacturing sector.

Table 1: Profile and Sample Units

Country	Type of Organization	Form of Ownership			
		Sole Trader	Partnership	Others	Total
Kenya	Service Enterprises	7	3	3	13
	Trading and Manufacturing enterprises	4	2	3	9
	Total	11	2	6	22
India	Service Enterprises	1	0	0	1
	Trading and Manufacturing enterprises	13	1	5	19
	Total	14	1	5	20
Total	Service Enterprises	8	3	3	14
	Trading and Manufacturing enterprises	17	3	8	28
	Total	25	6	11	42

The accounting system used by sample units from both the countries is given in table 2. The survey identified that 59% of SMEs in Kenya were using computerized accounting systems while others were using manual accounting systems. The percentage of SMEs using computerized accounting systems was found to be 35% in India, however, the difference between accounting system used from both the countries was statistically significant at 0.05 level of significance and one degree of freedom($x2$, $2.44 < 3.84$)

Table 2: Type of organization and accounting system used

Country	Type of Organization		Accounting System		
			Computerized	Manual	Total
Kenya	Service enterprise	Count	6	7	13
		% within group	27.3%	31.8%	59.1%
	Trading and manufacturing enterprise	Count	7	2	9
		% within group	31.8%	9.1%	40.9%
	Total	Count	13	9	22
		% within group	59.1%	40.9%	100.0%

India	Service enterprise	Count	1	0	1
		% within group	5.0%	0%	5.0%
	Trading and manufacturing enterprise	Count	6	13	19
		% within group	30.0%	65.0%	95.0%
	Total	Count	7	13	20
		% within group	35.0%	65.0%	100.0%

Education Background and Accounting Function

In order to reveal the educational background of employees to assess man-power capabilities of SMEs, the respondents wee required to mention the educational background of their employees (includes owners if actively involved in business operations) and how did they manage accounting function at their organization. It was revealed that educational background of employees at sample units was not encouraging. 61% of employees had a qualification lower than grade 10, 24 % were qualified between grade 10 – 12 and only 15% were qualified with degree and above. The sample-wise response regarding who maintains accounting records and prepares financial statements is summarized. On overall basis 47.6% of respondents were found managing accounting functions in-house while 28.6% were dependent on part-time employees and the remaining 23.8% were

using the services of practicing Chartered accountants. Looking at the educational background of employees including owner managers one can easily guess the quality of information processed for internal as well as for external users.

Users of Accounting Information

In order to reveal the focus of financial reporting, respondents were asked to identify the users of their financial statements (FS). 36% of respondents agreed preparing FS for internal users, 21% for external users and 43% opined that their FS are used by both internal and external users. The country-wise response was 41%, 32% and 27% respectively for Kenya, and 30%, 10% and 60% respectively for India, which is summarized in table 3. Though there is visible differences between the responses of the two samples it was significantly significant at 0.05 level of significance and 2 degree of freedom (x2, 5.3 < 5.99)

Table 3: Users of Accounting Information

Country		Users of accounting information			
		Internal	External	Both	Total
Kenya	Count	9	7	6	22
	% within group	40.9%	31.8%	27.3%	100.0%
India	Count	6	2	12	20
	% within group	30.0%	10.0%	60.0%	100.0%
Total	Count	15	9	18	42
	% of Total	35.7%	21.4%	42.9%	100.0%

Further to identify who among the external users were regarded as main users of SMEs financial statements respondents were required to identify the principle users of their financial statement using a six point forced ranking scale. On overall basis 56.4% of SMEs identified bankers and other lenders as the principal external user of their FS (Rank 1). The next major external user (based on average rank, medium rank and modal rank) was

identified to be tax authorities followed by suppliers, customers and others.

Books of Accounts

A question was designed to reveal the books of accounts maintained by SMEs, the obvious choice was cashbook, maintained on a regular basis. The next widely used book of account was general

ledger (maintained by all SMEs in Kenya and 75% SMEs in India) followed by general journal and register of fixed assets. 35% of Indian SMEs were found using separate debtors and creditors ledgers while in Kenya only 13.6% were found using separate debtor and creditor ledgers the reason being most of their business were on cash basis. It is clear that the accounting record kept by SMEs can be viewed as minimal

As far as objective of preparing financial statements is concerned compliance with regulation was identified to be the main objective (average rank 1.26), followed by providing information to external users (2.26) and usefulness for internal decision-making (3.15). The responses from 2 samples were slightly different but found to be insignificant based on Chi-square. It is a matter of

concern that SMEs do not view accounting information, as an aid to decision-making, possibly one of the causes behind the same is low growth and/or many business failures within the sector.

Bank Reconciliation Statement

Following the response that all SMEs maintain a cashbook on a regular basis, it was felt necessary to analyze how frequently they prepare bank reconciliation statements so as to keep control over cash. The sample-wise results are summarized in table 4. SMEs in India were found preparing bank reconciliation statements more frequently than their counterparts in Kenya the difference between frequency of preparing bank reconciliation statements by SMEs from 2 countries was significant at 5% level of significance and 2 degree of freedom ($x2$, $9.89 > 5.99$).

Table 4: Frequency of preparing bank reconciliation statement

Country		Frequency of reconciliation			
		Monthly	Quarterly	Longer than quarter	Total
Kenya	Count	7	10	5	22
	% within group	31.8%	45.5%	22.7%	100.0%
India	Count	16	3	1	20
	% within group	80.0%	15.0%	5.0%	100.0%
Total	Count	23	13	6	42
	% of Total	54.8%	31.0%	14.3%	100.0%

Provision for Bad Debts and Contingencies

SMEs selling their goods or services on credit were also required to respond about the bad debts and provision for bad debts if any. The response is summarized in table 5. The number of firms suffering from bad debts was comparatively low in Kenya the reason being majority of them sell on cash basis only. In Kenya, 25% of firms having bad debts agreed that they annually make a provision for bad debts. On the other hand 29.4% of SMEs from India were found making provisions for bad and doubtful debts while the number of those making provisions for contingencies was negligible (1 out of 42). 23.8% of respondents agreed doing aging analysis of receivables as well; 90% of those doing aging analysis were found using computerized accounting systems.

Table 5: Provision for bad debts

Country	Bad Debts	Provisions for bad debt (Number of SMEs)		
		Yes	No	Total
Kenya	No	14	0	14
	Yes	6	2	8
	Total	20	2	22
India	No	3	0	3
	Yes	12	5	17
	Total	15	5	20

Auditing

Only 52% of SMEs were found having their accounts audited which certainly raises concerns about reliability of their accounting information as opined by banks and other external users.

Regarding the use of depreciation method, 2 samples revealed entirely different sets of observations. In Kenya all sample units were found using straight line method which is in tune with local tax laws, while all sample units from India were found using diminishing balance method of depreciation accounting, as far as objective of preparing financial statements is concerned, 75% of respondents assigned rank 1 to compliance with regulation followed by information to outsiders and usefulness for decision-making. Respondents were equally divided over the issue of stock taking using both of physical, count and estimation. In response to format of balance sheet used, 43% agreed using account 'T' format while 57% revealed that they use statement form of balance sheet. Out of those using account T – format, 83% revealed using order of permanence in listing assets and liabilities. None of SMEs was found valuing goodwill. To study country-wide investment pattern of SMEs one way analysis of variants was used, which did not reject Null hypothesis, that capital investment in SMEs from both samples were statistically not different. Similarly, both samples were found identical regarding sales revenue and relationship between initial investment and sales. In response to inventory control techniques used, 36% of those, having inventory control mechanisms agreed using stock levels and 8% agreed using 2-bin systems.

Separate Cost Records

In order to reveal the role of accounting information in managerial decision- making at SMEs some questions were designed involving cost and management accounting aspects. 40% of SMEs in India agreed having some sort of separate cost records while only 25% of SME's in Kenya were found having separate cost record as summarized in table 6 both samples taken together exactly one third of sample units agreed keeping cost records.

Out of those having separate cost records 46.7% were using unit costing (mostly form India) 13.3% were using Batch costing and remaining were using Job costing. Whatever the cause of not keeping separate cost records be, it is obvious that most of the SMEs lack information that might be useful for them to manage costs for better performance. The percent of SMEs keeping separate cost record form the two samples was slightly different but the difference was not significant at 0.05 level of significant and 1 degree of freedom (x2, 2.26 < 3.84)

Table 6: Separate Cost Records

Country	Type of Organization	Separate Cost Records		
		No	Yes	Total
Kenya	Service	11	2	13
	Trading and manufacturing	5	4	9
	Total	16	6	22
India	Service	1	0	1
	Trading and manufacturing	11	8	20
	Total	12	8	20
Total	Service	12	2	14
	Trading and manufacturing	16	12	28
	Total	28	14	42

Overhead Classification

In order to reveal the classification of cost particularly of overheads for cost control purpose, respondents were requested to provide information about the basis of classification used. Table 7 summarizes the findings on overhead classification used by sample units.

Table 7: Methods of overhead classification

Country (I)	Basis of overhead classification (ii) (No. of SMEs)				No. Classification of overheads (iii)	Total (ii + iii)
	Functional	Variability	Both	Total		
Kenya	4	1	1	6	0	6
India	2	1	0	3	5	8
Total	6	2	1	9	5	14

Pricing Method

27 of active respondents (65%) were using cost plus method of price determination at times causing their products or services higher priced than competitors and loosing revenue. However, 12 respondents agreed taking into account the competitors prices while determining selling price of their products.

Record of Idle Time and Wage Methods

Information presented in table 8 reveals that majority of SMEs used time based wage payment methods. It was also revealed that most of them (74%) do not keep record of idle time which is justified by the fact that most of them do not use cost and management accounting records.

Table 8: Records of idle time and method of wage payment

Country	Idle time	Wage Methods		Total
		Time Rate	Piece Rate	
Kenya	Not Recorded	20	2	22
	Recorded	0	0	0
	Total	20	2	22
India	Not Recorded	9	0	9
	Recorded	10	1	11
	Total	19	1	20
Total	Not Recorded	29	2	31
	Recorded	10	1	11
	Total	39	3	42

Use of Managerial Tools for Financial Analysis and Decision- Making

The respondents were required to provide information about managerial tools used by them for planning, analysis and control purpose. 50% of SMEs were found preparing budgets and using comparative financial statements (FS), 36% were preparing cash flow statements, 33.3% used ratio analysis, 25% used investment appraisal methods and 21.4% prepared projected financial statements. No SME was found using trend analysis and number of those using make or buy decisions and product mix decisions was very low. The

percentage of SMEs preparing budgets from the two samples was 73% and 25% respectively, the difference being significant (at 5% level of significance, 1 degree of frequency). Among those preparing budgets, all were found preparing cash budgets followed by sales budgets (77.3%), purchase budget (55%) and master budget (27.27%). Those preparing labor and production budget was very low while no sample units prepared overhead budget. Comparatively less use of managerial and cost accounting tools indicates the potential where SMEs owners can be equipped with necessary skills, which may help them reaching better decisions and improving performance of their business.

Investment Appraisal

Response regarding investment appraisal revealed that only 25% of all sample units used any of investment appraisal methods (table 9). The response regarding use of investment appraisal was slightly different between two samples but the difference was insignificant at 0.05 level of significance and one degree of freedom ($x2$, $0.14 < 3.84$). As far as the method of investment appraisal is concerned payback, method was most preferred choice followed by net present value method and internal rate of return.

Table 9: Investment appraisal

Country		Investment Appraisal		Total
		No	Yes	
Kenya	Count	16	6	22
	% within country	72.7%	27.3%	100.0%
India	Count	14	4	18
	% within country	77.8%	22.2%	100.0%
Total	Count	30	10	40
	% of total	75.0%	25.0%	100.0%

Cash Flow Statement

The response gathered about preparation of cash flow statement revealed that 35.7% of all sample units agreed preparing cash flow statements (table

10) the sample-wise percentage of SMEs preparing cash flow statement was 45% and 25% respectively for Kenya and India the difference being insignificant at 0.05 level of significance and 1 degree of freedom (x2, 1.91 < 3.84)

Table 10: Cash flow statement

Country		Cash flow statement prepared		
		No	Yes	Total
Kenya	Count	12	10	22
	% within country	54.5%	45.5%	100.0%
India	Count	15	5	20
	% within country	75.0%	25.0%	100.0%
Total	Count	27	15	42
	% of total	64.3%	35.7%	100.0%

Processing of Tax Returns

A question asking who deals with tax matters revealed that 81% of SMEs (table 11) were dependent on outside experts fore tax services, which indicates lack of expertise at SMEs. It was also revealed that 60% of SMEs from India were keeping separate records for tax purposes while all the respondents from Kenya were found to be holding only one set of books, however most of them agreed making necessary adjustments mainly depreciation adjustment for determination of taxable income.

Table 11: Processing tax returns

Country		Who processes tax return		Total
		In house	Outside experts	
Kenya	Count	7	15	22
	% within country	31.8%	68.2%	100.0%
India	Count	1	19	20
	% within country	5.0%	95.0%	100.0%

	Count	8	34	42
Total	% of total	19.0%	81.0%	100.0%

Regarding inventory control, 48% of SMEs from India were found determining material levels, 68.4% were using FIFO method of inventory valuation, and others were found using LIFO and average cost methods. On the other hand, all SMEs from Kenya were found using FIFO method of inventory valuation of LIFO is not a permitted choice under IASs.

Other Findings

23.8% of the respondents felt that human capital should be accounted for as other assets but none of them was found having taken any steps in this regard. Awareness about the environmental impact of their activities and accounting for environment was also missing. Close supervision of employees was found to be most practical internal control tool. 74% followed by division of work, 36% and internal audit 12%. 40% of sample units were found working overtime to meet customer's demands and most of them agreed paying 20% more compensation for overtime work. Only one sample unit agreed paying more than 50% premium for overtime work.

Suggestions

The findings reveal that most of SMEs lack skill man-power to handle accounting work appropriately. Most of the sample units were found keeping minimum records to comply with relevant regulations and provide information for external users such as bankers and tax authorities. Based on survey findings the following suggestions are expected to help SMEs to deal with accounting and related aspects for their competitive advantage and improve performance.

It is advisable that SMEs are equipped with necessary managerial, accounting and technical skills to facilitate use of accounting and managerial skills that will increase relevancy and reliability of accounting information both for internal and external decision makers.

As revealed by survey results, SME owners suffer from lack of information for decision-making. Further, most of them do not use managerial tools

that may provide good insights of their business and help to manage it efficiently; therefore, it is needed to educate SME owners and managers about the role of management accounting information for decision-making.

In order to make preparation of accounting information attractive from cost benefit point of view, it is suggested that organizations such as trade associations and others create a pool of experts that may provide necessary services to member SMEs on rotational basis as and when need may arise.

Regarding proposed IFRS on SMEs accounting we are apprehensive that the standard may not be very useful for SMEs of developing countries such Kenya and India. As majority of SMEs in developing countries are much smaller in size (investment, sales or number of employees) than those in developed world. Further, IASB defines SME as an entity having no public accountability regardless of its size.

Careful review of various provisions reveals that the standard may not decrease the procedural burden significantly as envisaged in the draft standard. Perhaps there would be need for promulgating another standard focusing on the need of SMEs from small and developing countries.

Notes

Chi-square (x2 for table 2 and table 6 have been calculated after regrouping a sum of the frequencies were less than 5. As a result, the tables were reduced to 2 columns and 2 rows each hence; 1 degree of freedom was used for significance testing.

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