Accounting and Financial Reporting Practices of Small and Medium Sized Entities/ SMEs in Wolaita Sodo, Southern Ethiopia

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Abstract: The purpose of this study was to assess the current status of accounting and financial reporting practices by the Small and Medium Sized Entities/SMEs in Wolaita Sodo, Southern Ethiopia. Most of the studies conducted previously in relation to SMEs focus on the importance of SMEs and challenges faced by the SMEs in Ethiopia. Despite the importance of accounting to SMEs, little has been researched about the accounting and financial reporting practices of SMEs in Ethiopia. This research used descriptive cross sectional survey approach based on a statistical analysis of questionnaires completed by owner managers of SMEs. The sampling rate of 10% was applied across five major sectors/strata to come up with a sample of 67 SMEs owner managers. The findings from the study revealed that the accounting and reporting practices by the majority of the SMEs in Wolaita Sodo was not in line with the basic assumptions such as economic entity assumption and accrual assumption pointing out the major reason as lack of knowledge by the owner managers. For the daily recording of economic events majority of the SMEs use the single entry system. Most of the SMEs consider accounting as a means of complying with the requirement of the tax authority and rely on external consultants for the preparation of financial statements. From these findings, it is recommended that it would be better if the concerned regulatory bodies and other stakeholders give attention to the accounting and financial reporting issue of the SMEs so as to promote informed decision by different external stakeholders particularly creditors.

Key terms: Accounting and financial reporting, SMEs, owner managers, Wolaita Sodo.

1. Introduction

Even though there is no globally accepted common definition to SMEs, they are always playing significant roles in the real Gross Domestic Product (GDP) growth, new job creation and reduction of poverty in the global economy (Karadag, 2016). Peter Drucker, the father of post war management thinking said that small enterprises represent the main means of economic development. Those small businesses contribute extremely to achieving the basic goals to any national economy, becoming the backbone of social and economical progress

(Druker, 2009 cited in Neagu, 2016). This is supported by Association of Chartered Certified Accountants/ACCA report stating SMEs as the backbone of the global economy in the after effects of the global economic crisis of 2008-9 (ACCA, 2010).

SMEs represent over 99% of the total number of enterprises in most economies (OECD, 2017). According to the International Finance Corporation/IFC, 2010 cited in OECD, 2017 in developing economies, SMEs contribute up to 45% of total employment and 33% of Gross Domestic Product (GDP). As per Gebrehiwot (2006), the SMEs contribute up to 3.4% to the GDP of Ethiopia and 90% to the country's employment.

Even if SMEs are considered as backbone for the development of countries economy particularly in developing countries, they are facing a number of challenges. Among the challenges, access to finance and making informed business decisions are noted as the major constraints to the growth of SMEs in different countries including Ethiopia (Emeizie 2017; Getahun 2016; and John and Sylvester 2011). According to the World Bank (2015) report, the government of Ethiopia has been given major emphasis to the SMEs expecting the hopes of transforming the country's economy in Growth and Transformation Plan/GTP developing support packages concerning different stakeholders such as financial service providers, technical and vocational education institutions and various levels of government institutions. Despite the support packages, lack of access to adequate finance remains the most critical constraining factor for SMEs growth due to lack of acceptable and/or sufficient collateral and lack of credit history with banks. According to this report commercial banks take 92.6% of the total assets of the financial sector with which SMEs have almost no credit history. From the total small and medium enterprises, 3% and 23% respectively have credit line with banks. The report also found SMEs as the missing middles to have access to finance. Because, banks do have credit line with large companies and micro financing institutions are providing finance to the micro level enterprises (World Bank, 2015).

As indicated by Nega and Hussien (2016) banks and Micro Finance Institutions/MFIs in Ethiopia acknowledged poor accounting records by SMEs as one of the firm specific obstacles to provide credit to the SMEs. Access to finance was positively related to accounting practice of SMEs (Mosisa, 2011). According to Appui au Development Autonome/ADA asbl, 2017, Ethiopian MFIs primarily determine loan size based on the value of collateral as opposed to the creditworthiness or cash flow potential of the client and project. The study also noted that the amounts of credit that they require are all too often well above the value of the collateral they own. The level of credit risk affects the interest rate/cost of capital to the borrower and rate of return to the lender. Hence, to evaluate the credit risk of the businesses as well to determine the cost of capital, financial institutions required to see and evaluate the financial reports of the businesses. According to Nott, 2003 cited in

Nega and Hussien, 2016 in the absence of sufficient financial information especially in developing countries, banks generally rely on high collateral values, which according to bank reduce the risks associated with the problems of adverse selection and moral hazards resulting from imperfect information.

Generally, the access-to-credit environment is not conducive to businesses that are struggling for growth, require external finance, and are shortage of the collateral amount demanded by financial institutions. Therefore, one of the strategies to improve the SMEs access to financing and ensuring their sustainability and growth is improving their financial recording so as to enable the lenders of money/primary users of accounting information to make analysis regarding to the credit worthiness of these firms based on relevant and faithful financial reports. Beyond getting finance, having proper financial report has benefit to enable businesses to make informed decisions and enable intra and inter business comparisons thereby enhance competition and growth in each business sectors (IFRS foundation, 2015).

As emphasized by different literatures in the case of Ethiopia, opposing to the contribution of the sector to employment, its contribution to the GDP is very small. This could be due to little attention to the utilization of resources in the enterprises efficiently. The efficient utilization of resources also linked with making informed business decisions by the enterprises. To do so accounting information are very important. As far as the knowledge of the researcher is concerned, there had been no such study tried to assess the accounting and reporting practice of SMEs in Wolaita Sodo, Southern Ethiopia. Therefore, the purpose of this research was to investigate the status of accounting and financial reporting practices of SMEs from the SMEs owner managers' perspective. This study is expected to add knowledge in the literature regarding to the topic and enable different stakeholders to identify areas of deficiencies for future intervention.

2. Literature review

2.1. Definition of Small and Medium Entities/SMEs

There is no universally accepted definition of SMEs because in each economic system every country has its own classification according to its industrial regulation. When the International Accounting Standards Board/IASB develop International Financial Reporting Standard/IFRS for SMEs, the IASB did not impose any kind of specific size limits to define small companies for the adoption of IFRS for SMEs. Instead, it might specify that size limits which are already given in national legislation or standards could be adopted for the purpose (IFRS foundation, 2016). According to the definition set by Accounting and Auditing Board of Ethiopia/AABE which was based on the IASBs 2009 general definition, SMEs are entities that: do not have public accountability and publish general purpose financial statements for external users. Examples of external

users include owners who are not involved in managing the business, existing and potential creditors, and credit rating agencies (Federal Democratic Republic of Ethiopia/FDRE proclamation No. 847/2014 and IASB, 2009).

Recently, the National Micro and Small Enterprises/MSE development strategy guideline and the Development Bank of Ethiopia defined Micro, Small and Medium Enterprises/MSMEs by number of employees and paid up capital. According to this definition, small enterprises are enterprises having 6 to 30 employees and paid up capital of birr 50,001 to 500,000 (EUR 2,001 to 20,000) in the case of service sector and from birr 100,001 to 1,500,000 (EUR 4,001 to 60,000) in the case of industry or manufacturing sector. However, the Development Bank of Ethiopia recently set a definition of medium enterprises (for its lease financing operations) based on number of employees and total capital irrespective of the sector in which the enterprises operate. Accordingly, medium enterprises in both the manufacturing and service sectors are enterprises with 31-100 employees and/or with a paid up capital of birr 500,001 (EUR 20,001) to birr 7.5 million (EUR 300,000) (ADA, asbl, 2017).

2.2. Accounting and reporting practice of SMEs

Accounting is considered as the language of business and the most credible source of financial information about an entity to different stakeholders so as to undertake their respective decisions. The accounting and reporting practice in the double entry system is defined as; the process of identifying relevant and measurable economic events based on the source documents; keeping a systematic and chronological record of events measured in monetary units; posting the events to the ledger; balance-off the accounts and prepare trial balance; make adjustment to accruals and deferrals and communicates the collected information to interested users by means of accounting reports (Weygandt, Kimmel and Kieso 2013; Keiso, Weygant and Warfield, 2014). At the end of 2014, Ethiopia adopted IFRS which is based on the double entry system as a guiding principle for the financial accounting and reporting practice to the reporting entities where SMEs considered as reporting entities in the country (proclamation No. 847/2014). Double entry system is a system which records the two side effect of a particular economic event. To get relevant and faithful financial information from the system, the IASB's conceptual framework (2010) also sets the basic assumptions guiding the accounting process. Among the basic assumptions, economic entity and accrual basis of accounting assumptions are indispensable. In order to communicate useful information to the stakeholders for assisting them to undertake decision, there are some basic financial records that SME managers or owners need to keep. These basic records will normally include the sales day book (sales journal to record credit sales), purchases day book (purchases journal o record credit purchases), cash book (to record cash transactions), general journal, general ledger, receivables' ledger and payables' ledger (Onaolapo and Adegbite, 2014 as cited in Musah, 2017).

Contrary to the theoretical requirements, empirical studies conducted by Mehari and Pasha Shaik (2017) and Ali, Berhe and Mihret (2014) in Arba Minch town and Tigray region in Ethiopia respectively revealed, accounting practices of SMEs are not structured/at low level to produce required information to both external and internal users for decision making purposes. Poor accounting practice by SMEs was also acknowledged by different empirical studies conducted in different countries such as Stephen and Zotorvie, 2017 in Ghana; Madurapperuma, Thilakerathne and Manawadu, 2016 in Siri Lanka and Asaduzzaman, 2016 in Bangladish. Based on the above empirical studies some of the major reasons for poor accounting practice by SMEs were lack of technical knowledge of accounting by the owner/managers to the businesses, high cost of hiring qualified accountants and lack of clear guiding accounting rules.

2.3. Importance of accounting and reporting system for SMEs

Despite the actual accounting and reporting practice by SMEs, the place of sound accounting and reporting systems in any business, irrespective of its size, cannot be overemphasized. The growth of the SMEs can be determined through maintenance of proper records of accounts, which provides the basis for making proper operational and strategic business decisions. The growth and sustainability of a business is hindered if there is operational inefficiency, taking inappropriate decision, investing in the wrong projects etc.

There are plenty of studies emphasized on the importance of accounting and reporting practice by SMEs. For instance, as per Nwobu et al., (2015) some of the benefits of employing accounting services include increased accountability of business operations, reduced fraud, correct measurement of profit and achievement of managements' set goals. Musah (2017) stated the importance of proper record keeping and accounting by the SMEs in Ghana as enabling the businesses to make essential business decision; getting feedback after their action and making adjustment to the future and thereby reduce operating costs and improve productivity and efficiency by the businesses.

Conceptual framework

The conceptual framework for the study is based on the assumption that the current accounting and financial reporting practice is evaluated in terms of accounting system, basic assumptions: economic entity assumption and accrual basis of accounting assumption, types of financial statements, users and purpose of financial statements.
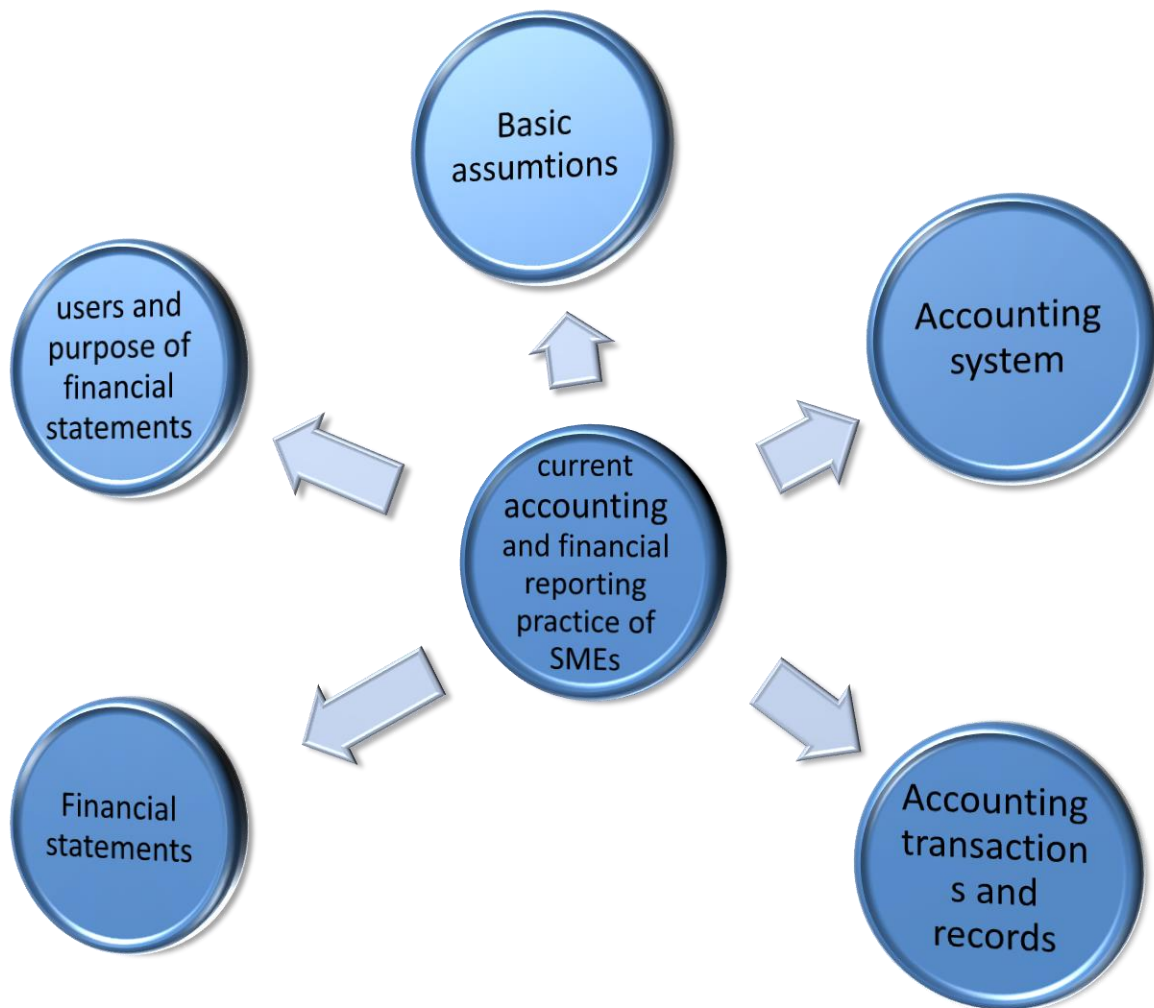
Figure 1: Conceptual frame work. **Source:** authors own construct.

3. Objectives of the study

General objective

The general objective of the study was to assess the current accounting and financial reporting practice of SMEs in Wolaita Sodo, Southern Ethiopia.

Specific objectives

- To evaluate the accounting practice by SMEs in light with the underlying assumptions to accounting.
- To investigate the types of accounting transactions and records being kept by SMEs.
- To describe the preparation of financial statements by the SMEs

4. **Methods**

Study Area

The study was conducted in Wolaita Sodo town in Southern Ethiopia. The area was chosen for this study because almost all businesses in the town are MSMEs and the researcher is in need of knowing the accounting and financial reporting practice of the businesses to push intervention in their point of deficiencies by different stakeholders.

Study Design

Research design refers to the plans and procedures for research that cover the decisions from broad assumptions to detailed methods of data collection and analysis (Creswell, 2009) Descriptive cross sectional survey design was employed to this particular study. A descriptive research design attempts to describe or define a subject, often by creating a profile of a group of problems, people, or events, through the collection of data and tabulation of the frequencies on research variables or their interaction, (Cooper & Schindler, 2006).

According to Bryman and Bell (2007), a cross-sectional survey is a design in relation to which data are collected using questionnaires or structured interviews with the intent of generalizing from a sample to a population Babbie, 1990 cited on Creswell, 2009. predominantly by self-completion questionnaires or by self-structured interviews on more than one case and at a single point in time in order to collect a body of quantitative or quantifiable data in connection with two or more variables which are then examined to detect patterns of relationship. A survey was used because it provides a quick, efficient, and accurate means of assessing information about a population.

Population

The target population selected to achieve the objectives of this study include SMEs registered with the trade and industry office of Wolaita Sodo town as of June, 2018. To differentiate SMEs in the town from other enterprises, the study assumed the definition set by National MSE development Strategy and Development Bank of Ethiopia triangulating with the definition given by IASB and AABE to adopt IFRS for SMEs. Accordingly, 670 SMEs operating in five major sectors (40 in construction, 60 in manufacturing, 210 in service, 330 in trade and 30 in urban agriculture) were considered.

Sample size and sampling technique

Bryman and Bell (2007) described a sample as the segment of the population that is selected for investigation. Sample is considered if the population size is unreachable with the available time and other resources. Sevilla et.al (at Tejero, 2006) stated that for descriptive study, the sample size is equal to 10% of the total population. 10% sample size was used by Tankana, 2015 for similar studies. Saunders, Lewis and Thornhill (2009) defined the sampling frame for any probability sample is a complete list of all the units in the population from which the sample units will be drawn. Hence, for this particular study the sampling frame consists of all units in the target population. Our sample covered 67 SMEs which were sampled from 670 SMEs as listed by the Trade and Industry Office of the town as of June, 2018.

The sampling technique used to draw sample units from the SMEs was the probability sampling method which ensured that each unit of the population had equal chance of being selected. The stratified random sampling method which is the process of selecting the assigned proportion from each stratum was used. It involves dividing the population into strata and then taking a random sample from each stratum. This sampling technique was preferred because the population is divided into several strata comprising the different major sectors that most SMEs operate in.

Table 1: SMEs in various sectors which were sampled for the Study, 2019

Types of Business sectors	Number SMEs per business sector	Sampling rate (%)	Sample size
Construction	40	10	4
Manufacturing	60	10	6
Service	210	10	21
Trade	330	10	33
Urban agriculture	30	10	3
Total	**670**	**100**	**67**

Data type and source

Quantitative data were used for the study. The study considered primary sources of data to assess the current financial accounting and reporting practice of SME. The owner managers of the SMEs in the sample were considered as the source for the required information+.

Data collection method

One set of questionnaire was developed for the owner managers which include open-ended and closed-ended questions and divided into three sections: characteristics of SMEs, the current record keeping practices of SMEs and reporting practices of SMEs. To minimize none response rate and ambiguity with the questions to the owner managers, the questionnaires were administered through the help of interviewers. Intensive training was given to data collectors on how to approach the respondents and collect the data.

Data analysis tools

Data from questionnaire were analyzed statistically using Statistical Package for the Social Sciences (SPSS 20). The analysis of data using SPSS allowed us to draw valid and reliable conclusions and recommendations. Data from questionnaires, especially open-ended questions were analyzed qualitatively in the form of discussion.

5. Results and Discussion

5.1.Respondents and SMEs Characteristics, Wolaita Sodo, Southern Ethiopia, 2019

Respondents gender category

Out of the 67 respondents, the majority were males (70.1%), with females comprising 29.9%. This clearly indicates the males' dominancy in managing the SMEs in the town. The result is consistent with (Getahun, 2016).

Age (in years) of respondents

The age distribution of respondents is shown in Table 2. Nearly half (47.8%) of the respondents were within age group between 31 to 40 years. The remaining 25.4%, 19.4% and 7.5% of the owner managers were in the age category of 20 to 30; 41 to 50 and above 50 age groups respectively. This shows that the young populations manage majority of the SME sector. The result is in support to (Musah, 2017).

Table 2: Age distribution of respondents

Age range	Number	Percent
20-30 years	17	25.4
31-40 years	32	47.8
41-50 years	13	19.4
Above 50 years	5	7.5

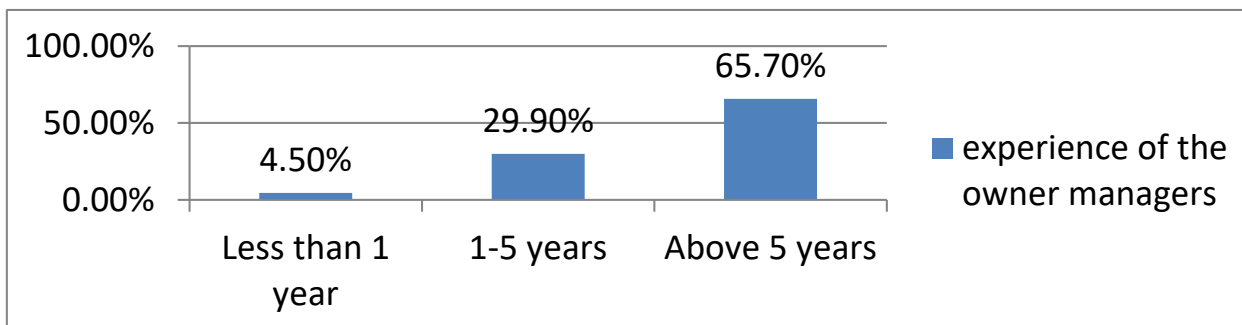**Source:** Field data, 2019

Respondents' Educational Level

More than one third (35.85%) of the SMEs owner mangers were learned up to secondary school level (figure 1). The results show that all of the respondents possess the level of literacy required to understand the issues rose on the questionnaire and as such would be able to provide reliable information about the SMEs' accounting practices. This also could be good opportunity to enhance the perfection of the SMEs accounting system through training of their owners.
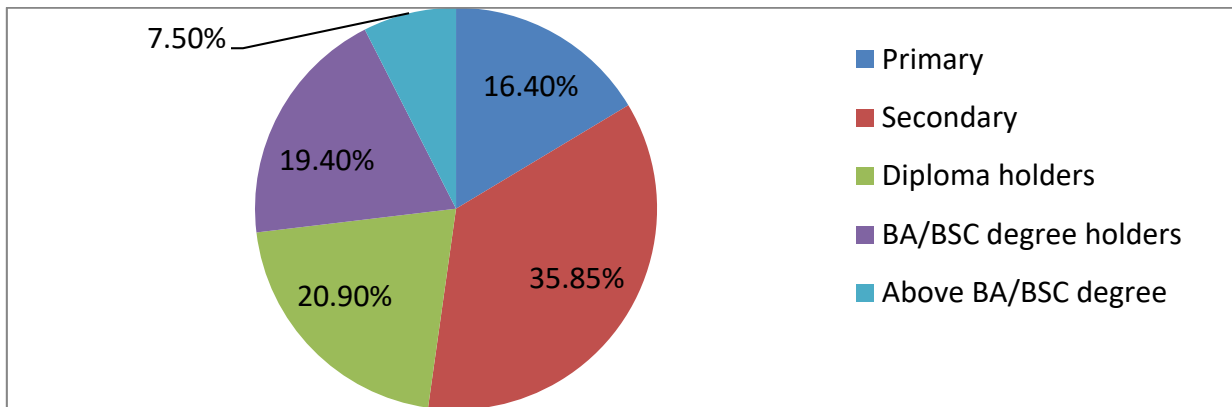
Figure 2: Respondents' education level. **Source:** Field data, 2019

Experience of respondents in managing their business

Data on respondents' experience in doing their business is displayed in Figure 3. 65.7% of the SMEs owner managers had experience of more than 5 years in doing their business and 29.9% have experience of between 1 to 5 years, whereas only 4.5% of the owner managers were beginners/ with the experience of less than a year. Therefore, as the result shows almost all of the owner managers do have good experience of managing their business which will help them to know in detail the economic events and the status of accounting practice of their respective businesses.

Figure 3: Respondents' experience. **Source:** Field data, 2019

Sector of Business Activities

Almost half (49.3%) of the SMEs in the town were operating in the trade sector (Figure, 4). This is mainly due to small capital required to start such business. The same cannot be said of manufacturing and construction sectors which require much capital and expertise. This could be good opportunity to install accounting and reporting system in accordance to IFRS for SMEs, because the types and numbers of business transactions to trading businesses is relatively less complex than businesses in the other sectors.
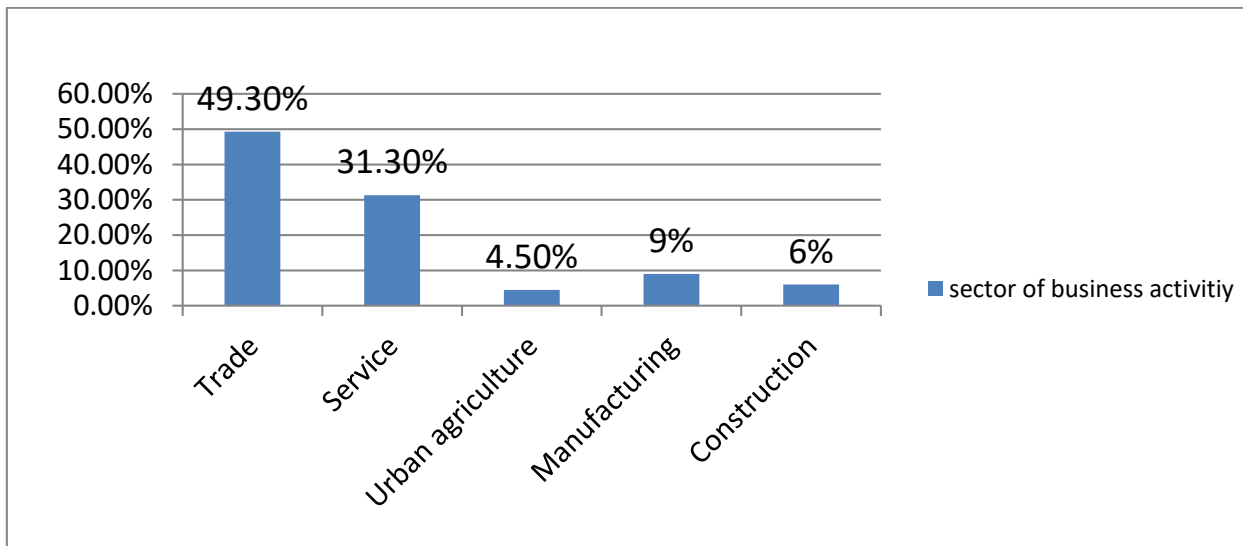
Figure 4: Sectors of business activities. **Source:** Field data, 2019

Number of employees in the SMEs

Number of employees is one of the key parameters used to define SMEs in most the countries. Majority (56.7%) of the SMEs were created employment opportunity for 6 to 30 individuals followed by 35.8% of SMEs employing 1 to 5 individuals (Figure, 5). This might be linked with the finding that majority of them were entities engaged in businesses that do not require a large number of employees to function. On the other hand, when we trace the definition for SMEs set by the development bank of Ethiopia in 2017, based on the number of employees 56.7% (6 to 30 employees) were small businesses and 6.0% (30 to 100 employees) were medium businesses.
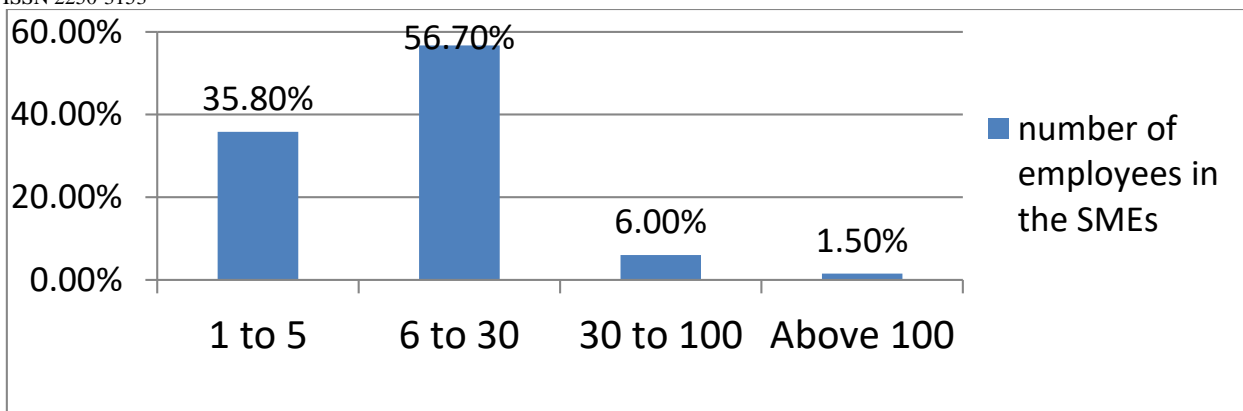
Figure 5: Numbers of employees in the SMEs. **Source:** Field data, 2019

Forms of business ownership

In figure 6, it has been shown that majority of SMEs (71.6%) were sole proprietorships followed by family owned (14.9%), partnership (9.0%) and private limited companies/PLCs (4.5%). This clearly shows the dominance by sole proprietorships, controlling more than two third of the enterprises among SMEs. The result is consistent with (Getahun, 2014).
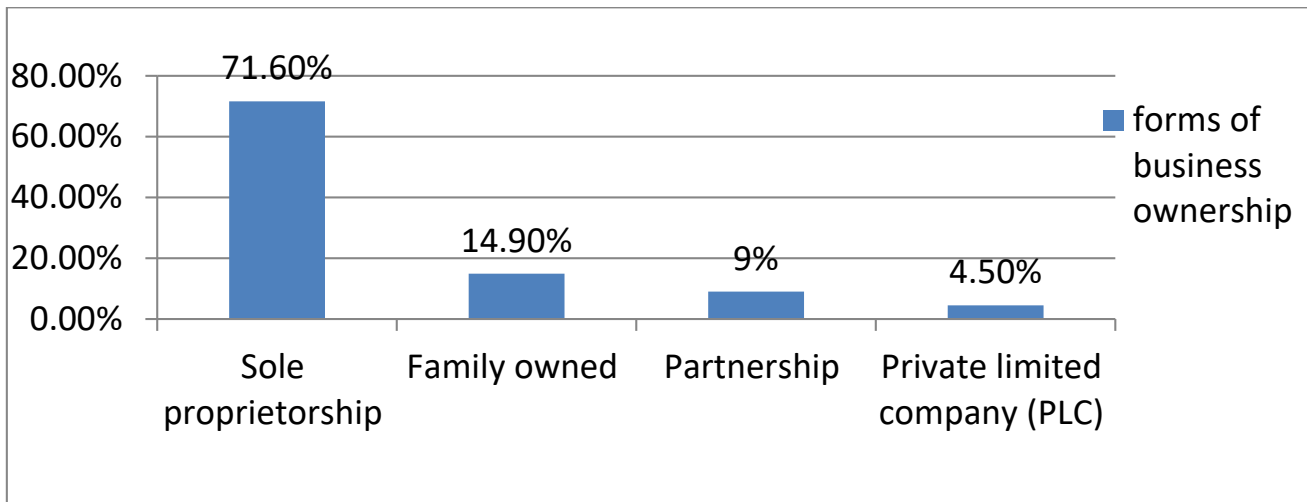

Figure 6: Forms of business ownership. **Source:** Field data, 2019

5.2. Accounting practice of SMEs in terms of the basic assumptions of accounting and financial reporting, Wolaita Sodo, Southern Ethiopia 2019

Economic Entity Assumption

Among the sampled SMEs, 58.2% did not segregate the activities of the businesses from the owner's personal affairs and other entities affairs for the accounting and reporting purpose (Figure, 7). In IASBs conceptual framework, economic entity assumption is one of the basic assumptions to external reporting (Keiso, 2014). Unless a particular reporting entity apply the economic entity assumption, the financial statements produced by the accounting information system cannot communicate fair and relevant information to the decision makers about the entity.
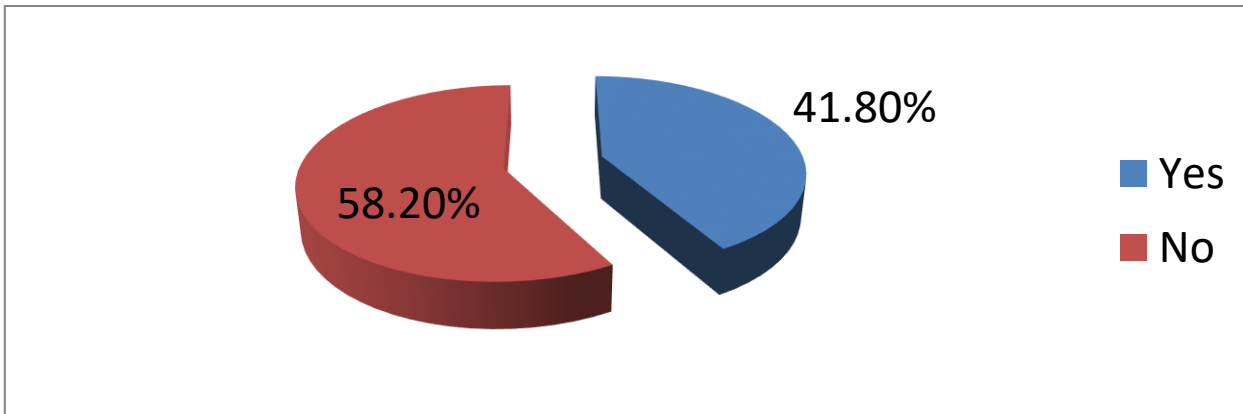
Figure 7: Economic entity assumption application by the SMEs. **Source:** Field data, 2019

Concerning reasons for not applying business entity assumption, 82.1% of the SMEs stated that lack of knowledge on basics of accounting whereas 7.7% of the respondents stated it is not important to their businesses because their businesses are small in size. The remaining 10.2% of the respondents stated other reasons such as considering their businesses as the source of meeting their basic needs so they do not have separate record, absence of follow up from any regulatory body, sole form of ownership, combining one entity income and expense with the other entity because all are owned by one person and because the entities were operating through capital from different sources and using the resources both for entities operation and personal use. It was also noted that as the owner managers level of education increase, the application of economic entity assumption also increase.

Accounting system

More than three fourth (76.1%) of the SMEs were using the single-entry accounting (Table, 3). Among those businesses using the single entry system, majority (72.5%) were indicated lack of knowledge on the double-entry system as the reason to use the single-entry system. This could be due to the reliance of SMEs on external consultants to the preparation of financial statements annually for the taxing purpose. Due to the absence of strict follow up from the regulatory bodies for the day to day recording of economic events, SMEs owner

managers were not forced to know about the modern accounting system. Simply they were collecting the necessary receipts and other documents and giving to their consultants so as to prepare financial statements required by the tax authority. The result also indicated that, the share of enterprises with double-entry accounting increases as the size of enterprise increases consistent with (Lindner and Hoelzl, 2012).

Bases of accounting

More than three fourth (80.6%) of the respondents indicated the recognition of revenue at the time of cash receipt or considering cash base whereas the remaining 19.4% were recognizing revenue when it is probable that future economic benefits will flow to the company and reliable measurement is possible (accrual basis of accounting). Among those respondents using the cash basis of accounting, 46.3% stated the reasons for the cash basis as lack of knowledge on accrual basis of accounting. Among the SMEs using cash bases of accounting, almost 89% were using the single entry system. Contrary to this result, IFRS for SMEs adopted by the government of Ethiopia with the proclamation No. 847/2014 require the accrual basis of accounting based on the double entry system for the preparation of general purpose financial statements by the SMEs in the country.

Table 3: Accounting practice of SMEs in terms of the choice for accounting system and basis of accounting, Wolaita Sodo, Southern Ethiopia, 2019

Variables		Number	Percent
System of accounting	Double entry system	16	23.9
	Single entry system	51	76.1
Reason for single entry (n=51)	Easier than double entry	12	23.5
	Lack of knowledge on double entry	37	72.5
	Others	2	4.0
Basis of accounting	Cash base	54	80.6
	Accrual base	13	19.4
Reason for cash base (n=54)	Easier for application	19	35.2
	Lack of knowledge about accrual base	25	46.3
	Others	10	18.5
	Others*: absence of credit sales and purchases; vouchers used as source documents were received or given on the date of purchase or sale		
NB: all of the SMEs with double entry system have been using debit credit rules.			

Source: Field data, 2019

5.3. Business transactions and types of accounting records being kept by SMEs, Wolaita Sodo, Southern Ethiopia, 2019

Transactions recorded by the SMEs

Almost all (97%) of the sampled SMEs were keeping record for purchase transactions followed by record for sales transaction (91.0%) (Table, 4). Recording purchase transactions could be to get the Value Added Tax/VAT refund for purchase with VAT and getting tax advantage with high amount of expenses relative to income. The smallest number (10.4%) consider recording of depreciation in relation to fixed assets. This result indicated that there were no complete recording of all measurable economic transactions and other events which can change financial position, financial performance and cash flow status of the entities. This is contrary to the IASB's conceptual framework which require complete recording for faithfulness of accounting reports.

Accounting records maintained by the SMEs

Among the accounting records considered in the instrument such as source documents, chart of accounts, journals, ledger and trial balances, 97% of the SMEs in the town were using the various source documents/vouchers and 77.6% were using journals as accounting records (Table, 4). Among the SMEs in the town, only 9.0% keep advanced forms of records such as chart of accounts and ledger whereas very few (6.0%) keep trial balance as a means of proofing the equality between the debit and credit entries.

Table 4: Business transactions and records held by SMEs in Wolaita Sodo, Southern Ethiopia, 2019

Variable		Number	Percent
Transactions recorded by the entity	Purchase of goods and service	65	97.0
	Sales of goods and services	61	91.0
	Decline in the value of long lived tangible assets/depreciation	7	10.4
	Payment of wages and salaries	37	55.2
Accounting records	Source documents	65	97.0
	Chart of accounts	6	9.0
	Journals	52	77.6
	Ledger	6	9.0
	Trial balance	4	6.0

Source: Field data, 2019

Source documents maintained by the SMEs

Among the SMEs using source document as a base for recording business transactions and other economic events, 92.5% were using purchase invoice to record purchases, sales invoice to record sales (83.6%), checks to record cash receipts and payments (25.4%), cost record to record cost of production (3%), contractual papers with customers and suppliers to record receivables and payables (20.9%), asset utilization plan to record depreciation (1.5%), payroll to record salary expense (52.2%) and special record forms for voucher less payments (26.9%). None of the SMEs were using the debit and credit memos to record the reconciliation adjusting entry in relation to cash in the checking account. Those SMEs which were not using any of the above source documents stated the reason as the absence of mandatory regulation (Table 5).

Among the SMEs keeping journals as the first book to record business transactions and other economic events, 42.8% were holding sales day book for recording of credit sales, purchase daybook for the recording of credit purchases (22.4%), cash book for the recording of cash transactions (23.9%) and general journal (35.8%) for other transactions (Table, 5).

Table 5: Types of vouchers/source documents and journals held by SMEs in Wolaita Sodo, Southern Ethiopia, 2019

Variable		Number	Percent
Source documents (n = 65)	Purchase invoice	62	92.5
	Sales invoice	56	83.6
	Checks to record cash receipts and payments	17	25.4
	Cost records to record cost of production	2	3.0
	Credit and debit memos	0	0.0
	Contractual papers with customers and employees	14	20.9
	Asset utilization plan to record depreciation	1	1.5
	Payroll to record salary expense	35	52.2
	special record forms for voucher less payments	18	26.9
Journals(n=52)	Sales daybook, for the recording of credit sales	28	41.8
	Purchase daybook, for the recording of credit purchases	15	22.4
	Cash book, for the recording of cash transactions	16	23.9
	General journal , for other transactions	24	35.8

Source: Field data 2019

5.4.The Preparation of Financial Statements by SMEs, Wolaita Sodo, Southern Ethiopia, 2019

Reasons for the preparation and preparers of financial statements prepared by the SMEs

Among the SMEs in the town, 94% were preparing financial statements. As it is shown on table 6, the leading reason for the preparation of financial statements by the SMEs was, for the taxing purpose because it is mandatory requirement by the tax authority. The result was consistent with Ali, Berhe and Mihret, (2014). Those SMEs which were not required to prepare statements by the regulation for the taxing purpose are businesses with annual turnover of less than birr 500,000. Hence, it is indicated that majority of the SMEs were with annual turnover of more than birr 500,000 and able to accommodate the cost of reporting if IFRS for SMEs come in to implementation.

More than three fourth of the SMEs in Wolaita Sodo town preparing financial statements lacks internal accounting staff and relay on external independent consultants for the preparation of financial statements. Among the remaining SMEs preparing financial statements, 7.5%, 4.5% and 6% were preparing with the enterprises' own accountant, owner manager of the enterprises', and in the enterprise with the cooperation of external consultants respectively. Some of the respondents pointed out that their consultants had been reluctant to show every detail about the accounting and reporting issue of their entity to themselves and they were not accountable to their activities. From this point it is understandable that, the owner managers want to have training on the basics of accounting and reporting to get better understanding on the accounting reports.

Table 6: Users of, reasons for the preparation and preparers of financial statements prepared by the SMEs in Wolaita Sodo, Southern Ethiopia, 2019

Variable		Number	Percent
Preparation of financial statements	Yes	63	94.0
	No	4	6.0
Users of financial statements (n=63)	Owner manager/s	34	50.7
	Employees	0	0.0
	Taxing authority	62	92.5
	Lenders and suppliers	16	23.9
	Others	1	1.5
Purposes of financial statements (n=63)	For making important operational and investment	33	49.3
	For support in getting loans	18	26.9
	For profit sharing	3	4.5
	For the calculation of	62	92.5

	income tax		
	Others	8	11.9
Outsourcing of preparation of financial statements (n=63)	Enterprise own accountant	5	7.5
	Owner manager of the enterprise	3	4.5
	External independent consultant	51	76.1
	In the enterprise with the cooperation of external consultants	4	6.0

Source: Field data, 2019

Types of financial statements prepared by the SMEs

As shown on table 7, the types of financial statements used for different purposes vary from SME to SME. This indicates irregularity in the preparation of financial statements. The complete set of financial statements in accordance to IFRS for SMEs include statement of financial position, profit and loss statement and comprehensive income statement, statement of cash flows, statement of changes in equity and notes to the financial statements (IASB, 2009, Par 3.17). Among these statements, the profit and loss statement was the statement prepared by the majority of SMEs in the town followed by the statement of financial position. This was due to the principal reason for the preparation of financial statements which was for the taxing purpose. According to the tax proclamation, those entities registered to VAT (entities with annual turnover above 1,000,000 birr) in Ethiopia has to prepare statement of financial position and profit and loss statement. Those entities with annual turnover in between of 500,000 to 1,000,000 birr required to prepare profit and loss statement for the taxing purpose. The finding also revealed that, absence of distinction between specific purpose and general purpose financial statements. In other words, all of the SMEs were using a particular statement for different purposes.

Table 7: Types of financial statements and the purposes to prepare financial statements by SMEs in Wolaita Sodo, Southern Ethiopia, 2019

Variables						
Financial statements and reasons	Statement of financial position/balance sheet	Profit and loss statement	Statement of cash flows	Statements of changes in equity	Notes and disclosure	Other
For making important operational	25(75.8%)	18(54.5%)	3(9.1%)	1(3.0%)	0(0.0%)	2(6.1%)

and financial decision (n=33)						
For support in getting loans (n=18)	14(77.8%)	15(83.3%)	3(16.7%)	0(0.0%)	0(0.0%)	3(16.7%)
For profit sharing (n=3)	0(0.0%)	1(33.3%)	0(0.0%)	0(0.0%)	1(33.3%)	2(66.7%)
For the calculation of income tax (n=62)	53(85.5%)	56(90.3%)	5(8.1%)	0(0.0%)	0(0.0%)	6(9.7%)
*others: Daily report for the purchase and sale for internal purpose; purchase report supported with voucher to have VAT refund						

Source: Field data, 2019

6. Conclusion and Recommendations

6.1.Conclusion

The study set out to determine the current accounting and financial reporting practice of SMEs in Wolaita Sodo, Southern Ethiopia. The study went further to evaluate the general accounting practice by SMEs in light with the underlying assumptions to accounting and to investigate the types of accounting records being kept and maintained by SMEs in the town. In addition to this, the study also aimed at describing the reasons to prepare financial statements and the types of financial statements prepared by the SMEs in the town.

The study pointed out that, majority of the SMEs in the town were not considering business entity assumption for accounting and reporting purpose (58.2%); use the single entry accounting system (76.1%) and consider the cash basis of accounting for the recognition of revenue and expenses (80.6%). The principal reason was lack of knowledge to the basics of accounting and reporting. Most of the SMEs were maintaining different forms of source documents and journals but few of them kept ledger, chart of accounts and trial balances.

Among the SMEs in the town, 94% were preparing financial statements. The leading reason for preparing financial statements by the SMEs was for the taxing purpose because they are required by the regulation. More than three-quarter of the SMEs in Wolaita Sodo town preparing financial statements lacks internal accounting staff and relay on external independent consultants. The types of statements prepared by the SMEs and the users showed great irregularity. Despite this irregularity, majority of them prepare profit and loss statement because it is a mandatory statement required by the tax authority to those SMEs with annual turnover of above 500,000 birr.

6.2.Recommendations

The recommendations coming out of this study will be useful for several parties, including regulatory bodies, entities, academics, and accounting professionals. First, for the proper enforcement of the accounting and reporting regulation in the country, there has to be nationally acceptable definition to SMEs operating in the country. Secondly, it is important for all stakeholders such as preparers, users, auditors, academics, regulators to participate in training workshops and continuous development courses. In these trainings, an appreciation of the importance of modern accounting and reporting by SMEs to different stakeholders would be created. Finally, different regulatory bodies of the country which have been worried about the growth of these businesses and the country as a whole need to give attention to the root cause for the problems faced by SMEs (constituting around 99% of the businesses in the country) particularly access to finance by developing and pursuing strong regulations for the accounting and reporting practices of SMEs in the country. By doing so, we can enhance the flow of funds in the country in an economically favorable way, employment opportunity by the sector and income of the government through increase in transparency in reporting of the economic affairs of those businesses.

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