

# Penetration of Accounting Practices among the selected SMEs of Arunachal Pradesh: An Exploratory Study

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## Abstract

Small and medium enterprises are integral part of Indian economy as majority of Indian population are from rural area which is why development of SMEs become priority for any economy. The development and growth of SMEs mainly depends on proper planning and proper management of finance. Due to scarce financial resources and management of accounts growth of SMEs is still lagging behind. The present study emphasizes to understand the current status of accounting practices among SMEs of capital complex of Arunachal Pradesh. The study was undertaken taking a sample of 200 SMEs operating in retail sector, service sector and entertainment/hospitality sector in the area. A structured questionnaire is designed to collect primary data from the respondents. Frequency and percentage are used for analysing and interpretation of data. The cross tabulation is also used to check the relationship between variables studied. The study found no relationship between the industrial sector and accounts prepared as revealed by the Chi square test. The study also concludes that SMEs of capital complex are more inclined toward cash transaction. Proper awareness and training should be provided to made aware of IFRS, GAAP, Ind-AS and accounting standards. Policies makers and government should develop customized accounting guidelines suitable for SMEs which would become convenient for them in preparing, maintenance of accounts for SMEs.

**Keywords:** Small and Medium Enterprises, Accounting Practices, Capital Complex.

## INTRODUCTION

India is considered one of the leading transforming economies (i.e., sixth largest) in the world (World Bank, 2020). SMEs contribute greatly to the growth of any economy and also to the sustainable development of every nation (Longenecker et al., 2008). It accounts for 45% of total industrial production, 40% of total exports and contributes very significantly to GDP. The manufacturing segment of MSMEs contributes 7.09% to GDP. MSMEs also contribute 30.50% of services and around 80% of the total industrial enterprises in India creating more than 8000 value-added products (Financial Express, 2021). Maseko et al. (2011) stated that there is no universal definition for

SMEs as their base of distinction varies from country to country, all the dimensions cannot be taken into account. However, the base that has been used across the globe are similar such as the size of the investment, several employees, financial position, annual turnover (Beck et al., 2005) but in reality, most SMEs have employees less than 50 (Pacter, 2009).

The swift growth in technology has changed the way business operates. Mihandi (2019) states that the present era of technological development has set foot in industrial revolution 4.0. Technological innovation has impacted every sector of the economy be it accounting, e-commerce or banking. Accounting provides necessary information regarding cost and

earning, profits and loss, liabilities and assets, policies and decision making for the business. The significance of measurement of financial performance for any business entity is completely understated work. Abdulle et al. (2019) agrees with the statement that in a fragile competitive business environment advanced accounting system would provide an edge over other competitors simultaneously benefiting the end products and services provided to customers. The emergence of e-commerce through ICT has distorted the way of doing business nationally and internationally for all sizes of businesses. As the pace of innovation evolve accounting system are also evolving from manually to computerized. An accounting system for any layman would mean proper maintenance and processing of accounts on daily basis. In another sense, the availability of financial statements and reports at right time to the right person (Amoako, 2013). Proper accounting information is essential for any business organization notwithstanding the size of an organization. SMEs have great potential for creating employment through self-employment eventually uplifting the lifestyle of the poor and contributing to development. Holmes & Nicholls (1988) have signified that accounting practices in SMEs are dependent on various factors of operating environment factors mainly the size of any entity, business age and grouping of the industry. Madurapperuma (2016) have identified that most SMEs employ professional auditors for auditing or preparing their firm's required accounts. It can be said that the practice of using sound accounting information systems (AIS) and their development can only be developed through the proper knowledge of owners or managers. SMEs are often accused of having less trained manpower with less efficiency in administration ultimately affecting the performance of the organization. Improper accounts along with other flaws can have a double disaster impact on decision making. Padachi (2012) emphasized along with accounting, management also has to prepare journals, general ledger, subsidiary journals, financial statements and essential other documents. This task requires an advanced accounting system that would allow SMEs to maintain proper accounts in a hassle-free manner, error and timely.

Accounting practices in SMEs system is assumed as the most awaited topic which has

been drawing attention to the administration of any organization as well as to academicians. SMEs need to prepare complete and relevant financial information. This research, therefore, concentrates on analyzing the types of accounting practices used by SMEs, the types of accounts kept and maintained by SMEs. There is no conclusive evidence but the literature has revealed that most SMEs do not maintain a proper record which makes it a prime concern for all researchers, academicians and economists. Research work does exist in the accounting practices of SMEs but not many research has been done in the aspect of Arunachal Pradesh which would not only benefit or open up new areas for further research in the academic field but benefit different managers to solve their practical problems within an organization. The present study area is a sub-district of Itanagar of the Itanagar capital complex. Itanagar is the capital of Arunachal Pradesh.

The desire to undertake a systematic investigation on the penetration of accounting practices among the selected SMEs of Arunachal Pradesh is due to less exposure of proper accounting practices adopted by SMEs of A.P. The SMEs of A.P have various challenges (non-availability of skilled labour, lack of advanced technology, inadequate knowledge, low production capacity, understanding the market, increasing export but if tackled properly can create an opportunity. According to Maseko & Manyani (2011) and Lalin & Sabir (2010) most SMEs do not maintain proper accounting records and do not abide by accounting norms which deteriorates the firms over time. They do not generate the necessary information required for taking a business decision which affects their position in long term. Appropriate accounting information is very essential for any firm to understand the trend of profit or loss of any firm. It is also known that traditional accounting at some point in time can deteriorate the efficiency and productivity of any organization. Since the advancement in the accounting system has become the need for any business houses to cope with the present situation especially now mainly with the involvement of digitalization and GST where records are to be maintained strictly and accounts are to be updated on regular basis.

There have been two main concerns about the adoption of new accounting tools and systems.

First, an assessment of practices within the companies has revealed considerable evidence of poor management of existing systems. One can only question whether the adoption of new accounting practices would lead to any long-term improvement in the collection of basic information. Second, those companies which have adopted new systems have not consistently operated themselves to their full benefit but the main problem that arises within the selected SMEs of the Itanagar Capital Complex is that even after the tremendous development in accounting they are still not maintaining proper records and employing traditional accounting practices in their business forums. Arunachal Pradesh can be considered as the least exposed place from an accounting perspective. Business houses have to advance themselves with their accounting system so that they can get a rebate on GST and other benefits or else they will have to continue to pay high GST and also through digitalization they can maintain their records properly and systematically which would avoid wastage of paper, fewer employees all of them are within the area of accounting practices itself.

A study in the context of Arunachal Pradesh is, thus, necessary considering the latest positions in the area of adoption of proper accounting practices in SMEs of Arunachal Pradesh. There are very limited studies conducted on the accounting practices of SMEs of AP which motivates us to take up this study.

## Reviews of Literature

Studies of literature have revealed that there is no fixed definition for small and medium enterprises because it is known that no concept can capture all the dimensions of SMEs in any academic discipline. It also does not reflect different entities, different industrial sectors, different countries or different levels of growth with one term of SMEs. It is universally accepted that most of the definition of SMEs is based on very similar criteria like investment, number of employees, annual turnover, size of the firm, financial position (Beck et al., 2005 & Ghafoor, 2007). However, none of these hold down the global universal discipline of SMEs, but in reality, it has been observed that even for developed countries they have less than 50 employees (Pacter, 2009). Hong Kong Institute of Certified Public Accountants have considered

a business firm if it does not exceed any two of the three criteria pegged as total annual revenue of HK\$50 million, total assets of HK\$50 million, at the reporting date, and 50 employees as SMEs (Chen, 2013). It has been noticed that the owner itself is the manager for most of the SMEs (Sian & Roberts, 2006). Newberry (2006) has suggested that owing small-scale business enterprises provides immense opportunity for growth to satisfy personal objectives along with firm's objectives. He has mostly considered mainly two prominent reasons for setting up a small-scale business (a) gaining independence and (b) earning additional income. The best feature about owning a small business is ownership, independence and satisfaction. Innovations are born in small firms through small ideas by analysing the gap of necessity, history is proof about innovations like airplanes, air conditioners, from giant computers to mini computers which led to successful businesses (Penwell, 2004).

## Accounting Practices and Financial Reporting of SMEs

SMEs do not prepare proper records of their transaction but the law requires all of the SMEs to prepare financial statements and have them audited, these financial statements are updated with the government to make available whenever needed on request. However, the majority of firms established in the capital complex of Arunachal Pradesh are unaware of proper accounting procedures. This information is considered very useful for any stakeholders or government for identifying the status. Holmes & Nicholls (1988) have identified that the volume of accounting information in SMEs is depended on several operating environmental factors that include size, business age, industrial group. Ismail & King (2007) stated development of accounting information system of SMEs depend on owner's level of accounting knowledge while Keasy & Short (1990) concluded that the majority of SMEs use professionals accounting firms for preparation of their annual accounts as their knowledge of accounting is considered incompetent for which they become dependent on them. Rencher (2002) suggests that there is no particular proof to suggest that financial accounting practices are based on Generally Accepted Accounting Principles (GAAP). These principles include various norms that SMEs should comply while preparing final

accounts. Zhou (2010) argues that owners/managers of small businesses should start indulging accounting software to improve their accounting practices lastly McMahon (1998) conclude that even though law prevails all SMEs to produce financial records they seem reluctant about it because of the fear that their internal affairs will become public to officials or any to their competitors.

#### Importance of Accounting Practices in Small and Medium Enterprises

According to the Kaplan & Bruns (1987) accounting is the process for analyzing and systematically recording in qualitative terms or any other unit of measurement, summarizing, reporting and interpreting the results themselves. Moreover, it has become necessary with the emergence of the corporation as a vehicle for mobilizing resources both capital and human. Kenneth (2013) states stakeholders of business entity uses accounting information as a guide towards their investment. A stakeholder can be any potential investor who is interested in the company. He has also identified that the need for accounting information is not static; accounting information changes according to societal needs, legal needs, economic structural changes and changes in policies of the firm all such factors need to be included while preparing the financial statement. It has been noted by the researcher that earlier accounts were prepared on a historical-cash basis then historical-accrual basis but today accounts are mostly prepared on current-cost accounting. Corporate social responsibility, regulatory compliance and risk management are also being center part of the discussion. Shim & Siegel (1999) considered that proper maintenance helps in taking rational business decisions. There are various policies like pricing policy, wage structure, competing with rivals' advertisement and sales promotion, etc all of which mainly rely on finance which is directly related to accounting information. Managerial decisions are mainly based on facts and figures prepared by an accountant because of which accurate accounting information becomes vital for any business firm. Baggaley & Maskell (2003) lastly concludes that proper communication and reporting are also made feasible through accounting records. The events and transactions maintained and recorded conveys the necessary information needed. This

information is then used by various groups related to business entities.

## OBJECTIVES OF THE STUDY

There are mainly two objectives of study which are

- To explore the status of using accounting practices among the selected SMEs in Arunachal Pradesh.
- To identify whether SMEs in the study area are using accounting systems for preparing and measuring their financial performance.

## HYPOTHESES

H1: There is a significant relationship between the industrial sector and financial statement preparation.

H2: There is a significant relationship between the accounting system and profit management.

## Research Methodology

The current study is based on an exploratory survey of selected SMEs in Itanagar Capital Complex which comprises of (Itanagar, Naharalagun, Nirjuli), selected through convenience sampling technique. The study also undertakes both quantitative and qualitative approaches. The study has used both primary and secondary methods for data collection. Articles, journals, research papers and books have been referred as secondary sources while a self-designed questionnaire was administered at workplace of respondents for primary data collection. The respondents were provided questionnaires to obtain information regarding accounting practices of SMEs and requested to fill the appropriate options according to them which included multiple choice and likert scale. The data were analyzed through the IBM SPSS using the mean statistics and cross-tabulation

The present research is based on an exploratory study of selected SMEs in the Itanagar capital complex. The present study area is a sub-district of Itanagar of the Itanagar capital complex. Itanagar is the capital of Arunachal Pradesh. The Itanagar Capital Complex has more SMEs

compared to neighboring places which is why the study area is considered more appropriate for achieving the research objectives. Therefore, in the present study all the registered tax-paying SMEs whose employees are less than 50 have been considered.

According to Arunachal Pradesh State Industrial and Investment Policy 2020, number of SMEs, as reported, under Udyog Aadhaar Memorandum (UAM) was 1046 comprising of Micro (615) and Small (431) enterprises in

Arunachal Pradesh as on 31st May 2019. Twenty percent of the universe has been considered for the study that figures 210 firms (incorporating indivisibility factor). The total acceptable sample size for the study is 200. The distributions of sampled organizations have been stratified into three selected categories (presented in Table 1). The rationale behind selecting three categories is either the extent of its business volume and least possible cycle time or the extent of its impact on consumer purchase.

Table 1. *Types of Business: Firms Composition of SMEs*

FMCG / Retailing Sector	Frequency	Health care Sector	Frequency	Service Sector	Frequency	Total
Departmental Store	26	Pharmacy	41	Restaurants	20	
Furniture Shop	9	Dental Clinic	14	Hotels	15	
Hardware Shop	12	Diagnostic Centre	13			
Electronics Shop	9	Eye Clinic	3			
Grocery Shops	25					
Car Dealership	13					
<b>Total</b>	<b>94</b>		<b>71</b>		<b>35</b>	<b>200</b>

Source: Survey

Table 1 depicts the composition of the industrial sector of selected SMEs. It has been segregated into three different parts which consist of FMCG / Retailing sector, Health Care sector and lastly Service sector. Table 4 depicts that FMCG/retailing Sector which have been segregated into six different groups starting with departmental store with (26 SMEs) followed by Grocery shops (25 SMEs), Car dealership. (13 SMEs), Hardware shop (12 SMEs), Furniture shops (9 SMEs), Electronic shop (9 SMEs), second is the healthcare sector which also grouped into four different units starting with pharmacy (41 SMEs), Dental clinic (14 SMEs), Diagnostic

Centre (13 SMEs) lastly Eye clinic (3 SMEs) and the third is service sector which includes Restaurants (20SMEs) and Hotels (15 SMEs). It is very evident from the data that FMCG sector have the highest number of SMEs, pharmacy have the maximum number of SMEs in healthcare sector, while in service sector which includes restaurants and hotels are more or less same.

## Results & Discussion

Table 8. *Industrial Sector \* Ownership of Business Cross tabulation*

		Ownership of Business				Total
		Family Business	Sole Proprietor	Partnership	Limited Company	
Industrial Sector	FMCG/ Retailing Sector	24	70	0	0	94
	Healthcare Sector	0	54	17	0	71
	Service Sector	0	0	28	7	35
	<b>Total</b>	<b>24</b>	<b>124</b>	<b>45</b>	<b>7</b>	<b>200</b>

Source: Survey

Table 9. *Industrial Sector \* Training in Accounting Cross tabulation*

		Training in Accounting		Total
		No	Yes	
Industrial Sector	FMCG / Retailing Sector	55	39	94
	Healthcare Sector	56	15	71
	Service Sector	23	12	35
Total		134	66	200

Source: Survey

The table 8 and 9 represent ownership of the industrial sector and which type of industrial sector provides training to its employees. Table 8 results depict that majority of the FMCG/ Retailing sector consists of sole proprietors (70 SMEs) followed by the family business (24 SMEs), Healthcare sector consists of 54 SMEs from sole proprietors, 17 from the partnership while for the Service sector 28 SMEs from the partnership and 7 SMEs from the limited company.

Table 9 shows the relation of how much training has been provided by the different industrial sectors. It is evident from data that out of total 94 retailing sector, 55 SMEs have agreed of not getting proper training, 39 SMEs have approved of getting proper training, for the healthcare sector only 15 SMEs get training while a majority of portion i.e. 56 SMEs do not get proper training. Out of 35 SMEs of the service sector, 12 SMEs are provided training to their accountants from the firm but 23 SMEs have not provided any training.

Table 10. *Industrial Sector \* Method of Accounting System Cross tabulation*

		Method of Accounting System		Total
		Traditional Accounting	Modern Accounting	
Industrial Sector	FMCG / Retailing Sector	13	81	94
	Healthcare Sector	51	20	71
	Service Sector	15	20	35
Total		79	121	200

Source: Survey

Table 11 *Industrial Sector \* Who Prepare the Financial Statements Cross tabulation*

		Who prepare the Financial Statements				Total
		Full-time accounting officer	Owner-manager	External Auditor	Using Customized Software	
Industrial Sector	FMCG/ Retailing Sector	19	66	6	3	94
	Healthcare Sector	9	14	48	0	71
	Service Sector	0	0	20	15	35
Total		28	80	74	18	200

Source: Survey

Table 10 is the cross tabulation of the industrial sector and accounting system to find out the relation between them. Out of a total of 79 SMEs

using the traditional method 13 SMEs consist from the retailing sector, 51 SMEs from the healthcare sector, 15 from service sector while

out of a total of 121 SMEs using modern accounting 81 SMEs consist of the retailing sector, 20 SMEs from the healthcare sector, 20 SMEs from service sector. Industries are using the computerized system but they are not using any accounting software, only a few of them are using it, most of them are using it for the recording of transactions.

Table 11 depicts the crosstab between the industrial sector and those who prepare the financial system to find out the relationship between them. It is evident from the data that out of a total 94 retailing sector, 19 SMEs have full-time accounting officers, 66 SMEs owner/manager prepare their financial statements, 6 SMEs financial statement is prepared by an external auditor, 3 SMEs use customized. Out of the total of 71 healthcare sector, 9 SMEs use full-time accounting officers, 14 SMEs owner/managers prepare financial statements, 48 SMEs have an external auditor for preparing financial statements. Out of total 35 SMEs of service sector 20 SMEs use external auditor for preparing financial statement while 15 SMEs uses customized software. It is evident from the data that the majority of retailing sector owner's/manger prepare their financial system, for healthcare sector majority of SMEs have external auditor while for service sector they full-time accounting officer for preparing their financial statements.

**Financial Records Maintained by SMEs**

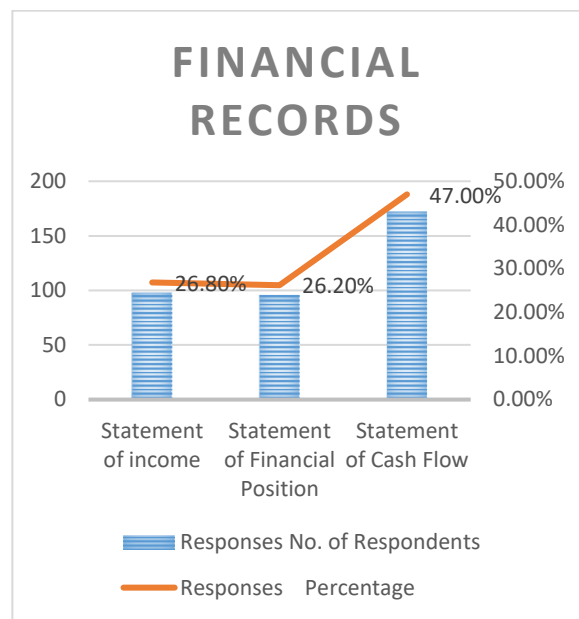


Figure 1, Source: Survey

**Accounting records prepared by SMEs**

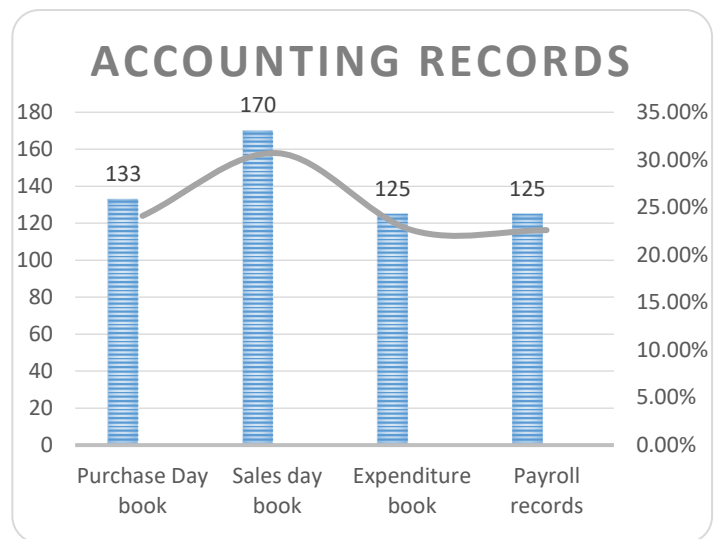


Figure 2, Source: Survey

Table 12. Accounting Records\*Sector Cross tabulation

		Financial Records Maintained			
		Purchase Day Book	Sales Day Book	Expenditure Book	Payroll
Industrial Sector	FMCG / Retailing Sector	62	94	66	51
	Healthcare Sector	46	56	31	63
	Service Sector	25	20	28	11
Total		133	170	125	125

Source: Survey

Figure 1 and 2 represent the composition of the Financial report and Accounting records prepared by SMEs. Figure 1 is divided into three different groups starting with a statement of income, a statement of financial position, statement of cash flow. Out of total 200 SMEs, 49.5% prepare a statement of income, 48% prepare a statement of financial position while 86.9% prepare a statement of cash flow. It is very evident that maximum SMEs prepare a statement of cash flow because most of the selected respondents are from the retail sector in which transaction in cash is done more frequently.

Figure 2 depicts the composition of accounting records prepared by SMEs which has been divided into four different groups (Purchase Daybook, Sales daybook, Expenditure book, Payroll records). Out of a total of 200 SMEs purchase days are prepared by 66.5%, sales day book (85.50%), expenditure book (62.5%) and payroll (62.5%). It can be easily understood that maximum SMEs prioritize sales day book then

followed by purchase day book and lastly both expenditure book and payroll are of the same percentage. Table 12 shows the cross-tabulation between accounting records maintained and industrial sector. Cross tabulation depicts that the purchase day book is prepared by 62 SMEs of the retailing sector, 46 SMEs of the healthcare sector, 25 SMEs from the service sector. The sales day book is prepared by 94 SMEs of the retailing sector, 56 SMEs of the healthcare sector, 20 SMEs of the service sector. The expenditure book is prepared by 66 SMEs of the retailing sector, 31 SMEs of the healthcare sector, and 28 SMEs service sector and lastly, payroll is prepared by 51 SMEs of the retail sector, 63 SMEs of the healthcare sector, 11 SMEs of service sector.

Testing of Hypothesis:

H1: There is a significant relationship between the industrial sector and financial statement preparation.

Table 13. *Test Statistics*

	Statement of Income	Statement of Financial Position	Statement of Cash Flow
<b>Chi-Square</b>	0.080 <sup>a</sup>	0.320 <sup>a</sup>	0.720 <sup>a</sup>
<b>df</b>	1	1	1
<b>Asymp. Sig.</b>	0.777	0.572	0.396
a. 0 cells (0.0%) have expected frequencies less than 5. The minimum expected cell frequency is 100.0.			

Table 13 shows the results of chi-square analysis to measure the association between the industrial sector and financial records prepared by the firm to understand the financial position of the firm. The three-chi-square represent that null hypothesis is accepted since the value of p is greater than 0.5 in all three scenarios. This proves that there is no relationship between the industrial sector and accounts prepared by the SMEs.

H2: There is a significant relationship between the accounting system and profit management.

Table 14. *Chi-Square Tests*

	Value	df	Asymptotic Significance (2-sided)

<b>Pearson Chi-Square</b>	28.524 <sup>a</sup>	2	0.000
<b>Likelihood Ratio</b>	30.301	2	0.000
<b>Linear-by-Linear Association</b>	0.358	1	0.550
<b>N of Valid Cases</b>	200		

Table 15. *Symmetric Measures*

		Value	Approximate Significance
<b>Nominal by Nominal</b>	<b>Phi</b>	0.378	0.000
	<b>Cramer's V</b>	0.378	0.000
<b>N of Valid Cases</b>		200	



Table 14 shows the results of chi-square analysis to measure the association between the accounting system and profit management. Since the chi-square goodness of fit is 0.00 calculated value is 0.00 which is less than the p-value of 0.05, therefore the null hypothesis is rejected, hence it can be said that there is a significant association between them.

As we know chi-square analyses measure whether there is any association between the variable because of which hypothesis is set up but the strength of association is determined by symmetric measures. Since a value of Phi is 0.3 which is considered a strong relationship as it is very close to 0.4 (A value of Phi = 0.1 is considered small effect, 0.3 a medium effect, 0.5 a large effect)

## Conclusion

The primary value and benefit of maintaining a proper accounting system is complete control over business expenses, sales and incomes. SMEs are expanding their business without giving proper attention to the accounting system despite accounting system being one of the major factors of any business firms. However, SMEs despite not having proper experience in business and accounting SMEs level of satisfaction is satisfactory regarding their current accounting system which depicts their negligence about the importance of accounting system. The ministry responsible for SMEs should initiate an awareness program about the benefits of an accounting system. The regulator should also come up with customised policies keeping in view of the given local market and their level of accounting knowledge instead of blindly imposing any foreign principles. Training should be provided for a better understanding of accounting information to acquire the required skills needed, better management control, and decision-making purpose to understand the market and maximize the profits in the corporate world. Further proper recording should be made mandatory to improve accounting practices to formalize the business operation and should not be solely based on tax purposes only.

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