

Assessing the financial reporting practices of micro enterprises in Mizoram

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Abstract: The main aim of this research is to generate an insight on the financial reporting practices of the Micro enterprises in Mizoram. It was also aimed at determining the accounting records kept by the micro enterprises as well as the purpose of maintaining accounting records. To achieve the research objectives, a structured questionnaire was developed containing open ended and close ended questions. Primary data were collected using Purposive Random Sampling techniques from 200 respondents, 100 each respondent from manufacturing sector and servicing sector. Percentages and frequency tables were the main medium used for analyzing the collected data with Statistical Package of Social Sciences (SPSS 22.0).

The results of the study concluded that majority of the respondents were familiar with basic accounting practices but most of them failed to maintain complete or proper books of accounts. Furthermore, it had come to light that lack of required skill and knowledge to prepare proper records contributed the most on the reasons for failure of complete accounting records by the respondents. The results also revealed that in most cases the owners themselves record their financial transaction which may result in low quality and inaccurate reports as they lack knowledge on complex accounting system. It was recommended that microenterprises should improve their accounting skills and increase their knowledge by joining any training for seminar on the accounting practices toward the effectiveness of their financial management and entrepreneurial development. Finally, the researcher recommended that implementation of accounting practice by knowledgeable person as it provides true reflection of the enterprises financial performance that required for quality decision making towards success.

Keywords: Micro enterprises, MSME, accounting practice, challenges, books of accounts, financial performance, financial reporting

INTRODUCTION

Many economies across the world have been built by small scale companies. However, many die out quickly after they are established. Small enterprises' poor financial management is accountable for this concern. Small scale businesses are an essential component of every nation's economic activity. They are critical to nation building. It is expected that as they develop and expand, so will the economy. Small enterprises provide jobs and are an important instrument for poverty reduction and economic growth.

Microenterprise as a form of entrepreneurship had been characterized as one of the major forces for job creation, further contributed to the economic growth, and their contribution was mainly depended on their performance. The uniqueness of micro business calls for careful consideration in the design of accounting systems. The vast majority of businesses in the economy's primary and intermediate production are micro enterprises. Micro enterprises use a unique accounting system. According to Mwangi (2011), they have a distinct unrecorded accounting system and may adhere to accounting practices directly or indirectly (Uddin et al 2017). The accounting practice of a micro enterprise refers to the process by which its accounting policies are implemented and followed on a regular basis, typically by the owners and/or auditors or a team of accounting professionals.

According to Uddin et al. (2017), accounting system is used to manage, monitor and control the income, expenses, and other financial activities of a business, including to prepare for the taxation purpose as well as supporting the organizational functions. Furthermore, it also useful to measure the financial performance of the company. In other cases, Mbroh and Attom (2011) observed that businesses that are keen in determining their profitability ought to include

appropriate accounting principles, concepts, principles and standards to ensure the consistency of measurement.

Accounting records involve the documentation of all transactions of the business entity, including its assets and capital (equity and liabilities), and in order to solve business limitations such as lack of finance, weak institutional capacity, lack of managerial skills and training of small-scale enterprises, there is a need for business management expertise to properly manage the finances, purchases, sales, production, and human resources aspects of the business. Accounting is important because it allows businesses or organizations to understand their financial position at any given time, which improves the development of strategies to reposition the business for further expansion and growth. In order to properly develop micro enterprises, there is need for them to adopt and develop proper accounting practices.

Majority of the people in India are living in rural areas drawing their livelihood from agriculture and allied sectors. The government of India is striving to improve the economic and social conditions of rural population and non-farm sector through a host of measures including creation of productive employment opportunities based on optimal use of local raw materials and skills as well as undertaking interventions aimed at improving supply chain; enhancing skills; upgrading technology; expanding markets and capacity building of the entrepreneurs/artisans and their groups/collectives. Therefore, the Government of India launched Micro, Small and Medium Enterprises Development (MSMED) Act in 2006 with an intention of facilitating the promotion, development and enhancement of the competitive advantage of micro, small and medium enterprises.

SIGNIFICANCE AND SCOPE OF THE RESEARCH

In India the role of Micro, Small and Medium Enterprises in the economic and social development of the country by fostering entrepreneurship is well understood. The Micro, Small and Medium Enterprises (MSME) sector promotes job creation, exports of the country and manufacturing of goods. Prasad (2001) summarized that by promoting the growth of small

business entities, the productive sector of the economy would broaden, revenue collected by means of tax would increase and on the larger scale it would help in reduction of poverty as employment opportunities would be generated. MSME sector is estimated to generate employment to about 11.10 crore people throughout the country. Moreover, the sector has the highest growth rate among the entire industrial sector. The sector has manufactured around 6000 products varying from traditional to high-tech products. It is widely known that after agriculture, the MSMEs provide the maximum opportunities for both self-employment and jobs. Micro sector is the largest sector with 630.52 lakh estimated enterprises generating employment to 1076.19 lakh persons, which accounts for around 97% of total employment in the sector. (Annual report 2019-2020, Ministry of MSME).

The uniqueness of micro business calls for careful consideration in the design of accounting systems. Micro enterprises are a vast majority of businesses found in variety of primary and intermediate production of the economy. These establishments have tremendous impact on the state and well-being of the nation in employment generation, as sources of national outputs and revenues, providing feedstock for large corporations. They may be unable to afford the complexities of a detailed accounting system but their accounting process is quite profound. Every business needs to have a reliable accounting practice and internal control systems regardless of its scale of operations. Numerous small-scale businesses are unable to understand the complexities of a detailed accounting system henceforth they follow single entry system of booking and in some cases, they have incomplete records. The importance of small business units in the economy of India as well as Mizoram is well accepted fact. The present study, therefore, restricted itself to the study of micro enterprises located in Mizoram.

STATEMENT OF THE PROBLEM

Accounting aspect of a small business is often assumed as most neglected area, because owners/managers of the small enterprises do not understand its functions and utilities for business survival and growth. As a result, they cannot do simplest things like keeping track of

the cash or know the financial status of their business (Bowen et al, 2009). Further, Gebremedihin (2019) stated that the micro enterprises in Sodo town, Ethiopia have understanding on the importance of accounting practices for the growth of enterprises but failed to implement it. The reasons are lack of skills to handle asset and liability to prepare financial statements, distrustful attitude of owner, and cost of hiring and fear of tax.

For these reasons Micro enterprises offer a potentially rewarding location for investigating financial accounting practices and exploring the factors underlying their development. At present in Mizoram there is a shortage of information on the awareness and extent of use of financial accounting practices among the micro enterprises of Mizoram. Lalrinsangi & Fanai (2020) revealed that majority of the micro enterprises in Lunglei failed to keep complete records of financial transactions as they lack technical skills and expertise. Also, they lack proper understanding of the necessity to maintain proper books of accounts. Given their small size especially in the context of developing countries, there is a possibility that micro enterprises were not aware about tools and techniques available for managing small businesses and inability to take full advantage of the opportunities that may create better accounting information for business decision making. The absence of data on financial accounting practices in micro enterprises has perhaps prevented the Indian regulators/policy makers from taking actions that might improve the functioning of Indian MSMEs. Consequently, there are significant gaps in the knowledge base relating to awareness of financial accounting practices and their uses for better management of Micro enterprises in Mizoram and in India as well, which should be filled on the grounds that the information provided may strengthen government policy towards the sector. Lalrinsangi & Fanai (2020) revealed that majority of the micro enterprises in Lunglei failed to keep complete records of financial transactions as they lack technical skills and expertise. Also, they lack proper understanding of the necessity to maintain proper books of accounts.

OBJECTIVES OF THE STUDY

1. To investigate the types of accounting records being kept and maintained by micro enterprises.
2. To find out the financial reports prepared by the micro enterprise and how often do they write up the financial reports.
3. To identify the reasons/challenges for not keeping proper accounting records.
4. To know the impact for not keeping proper accounting records and writing financial reports on firms financial performance.

RESEARCH METHODOLOGY

Research type

Exploratory research design was adopted for the proposed study to understand in detail the concept and extent of accounting practices adopted by Micro enterprises in Mizoram.

Population of the study

The study covers micro enterprises in Mizoram who are registered under District Industries Center, Directorate of Commerce and Industries, Government of Mizoram. For the purpose of this study, micro enterprises from the various enterprises comprises of manufacturing sector and service sector will be selected. There were 9720 registered micro enterprises in Mizoram and are divided into three categories, i.e, Manufacturing, Servicing and Manufacturing & Servicing sector.

Area of coverage

The area of study was limited to Aizawl City and Lunglei Town since majority of micro enterprises are located within their region (Entrepreneurship Cell, Directorate of Commerce and Industries, Government of Mizoram).

Sample size of the study

The sample size consists of 100 respondents each from the two districts and selecting 50 respondents each from manufacturing and service units. Purposive sampling method was used to

identify micro enterprises which are having GST registration and in existence of five years and beyond of their operation.

Collection of Data

The data was collected from both primary as well as secondary sources. Primary data was collected from respective respondents. For collection of primary data, a structured questionnaire with open ended and close ended questions was prepared for the target respondents in order to analyze the micro entrepreneur's record keeping practices and financial reporting practices.

Secondary data needed for the research was collected through various sources such as books, journals, bulletin, newspapers, published and unpublished thesis and dissertations, published and unpublished documents by the State and Central Government, reports and websites, etc.

Tools

Descriptive statistics, mainly frequency tables and percentages were the medium used for the analysis.

REVIEW OF LITERATURE

Kushnir (2019) explained that microenterprises are the lowest form of enterprises in terms of size that could be measured by either investment or employment or total assets of the firm. Bruhn and McKenzie (2014) posited that the majority of the microenterprises in most countries remain as an informal entity. Microenterprises are usually small in size; however, they are responsive and capable of taking benefit of positions which larger enterprises are unable to embark on successfully. Ladzani and Vurren (2002) stated that the existence of microenterprises in every country is considered very important because of their ability to contribute to the enhancement of the social economy, to increase income-generating jobs, to explore new entrepreneurial talent, to develop marginalized areas, to improve the standard of living of the community, to create conditions for sustainable living and eliminating extreme poverty.

Maseko and Manyani (2011) contended that micro and small business record keeping is the backbone of one's business. Whilst, Muteti et al. (2018) observed in their study that most enterprises kept several important accounting records in their business including purchases records, sales records and expenses records. The majority of micro business do not fully used their accounting information because lacking business knowledge and accounting skills. This is proved by several studies that due to these main reasons, numerous micro businesses could not prepare and practiced comprehensive records of account (Mbroh & Attom (2011), Muteti et al. (2018), Sanga et al. (2014), Sibanda and Manda (2016), Musah (2017), Mutambanengwe (2012), Everaery et al. (2006), MC Mahon (1999) & Osuala (1993)] and the cost to hire professional and qualified accountants (Mbroh & Attom (2011), Amoako (2013)).

Mwangi (2011) in his study revealed that small and micro enterprises do have an unrecorded accounting system. He also states that the existence of informal trade in which small and micro enterprises thrive cannot be dismissed as transitory. Muteti et al. (2018) found that entrepreneurs keep notes to in order to remember, observe progress and track profit. Whereas, Germain (2019) posited that SMEs perceive record keeping as a method of recovering initial investment in the form of cash at the end of the accounting period. However, if SME's accounting records are not maintained properly, long term sustainability of the business could be affected.

The study of Roslan et al. (2018) found that small businesses daily transactions were recorded manually, some owners do not know the differences between revenue and net profit and majority of them did not maintain any financial reports for the business. Pavtar and Agir (2017) concluded that, SMEs in general are bedeviled with a lot of challenges. The pivotal of all these challenges is anchored on their inability to prepare financial reports as a result of poor records keeping, fear of exposing the business to danger if business information is made public, high cost associated with financial reporting and lack financial and accounting education. They further claim that there is high level of illiteracy, in terms of basic financial records keeping and financial reporting, on the part of small business owners.

Lalhunthara (2015) in his study on the entrepreneurship in micro enterprises in Aizawl district revealed that the entrepreneurs do not keep proper records of their business transaction and most of them do not have training or skill development programme. Priskil & Fanai (2018) stated that the food and grocery shop owners of Mizoram do not have proper records of their business transactions and therefore cannot determine their net profit. Lalrinsangi & Fanai (2020) revealed that majority of the micro enterprises in Lunglei failed to keep complete records of financial transactions as they lack technical skills and expertise. Also, they lack proper understanding of the necessity to maintain proper books of accounts. Sales book and debtor's book were most commonly used for keeping records of financial transactions.

DATA PRESENTATION AND ANALYSIS

Financial Record keeping in Micro Enterprises

Keeping of financial records

Financial records keeping is the process of recording all the financial transactions and events that occur in the business. This is essential to the business because all assets that flow in and out of the business as well as liabilities incurred and settled must be accounted for. Without proper records it is difficult to give good account of the business activities. The study revealed that 72 percent of the entities keep financial records while 28 percent do not keep records at all. This implies that majority of the entrepreneurs appreciate the importance of financial records keeping to a business.

Table 1 Record keeping

	Frequency (in no.)	Percent (in %)	Valid Percent (%)
Keep	144	72.0	72.0
Do not keep	56	28.0	28.0
Total	200	100.0	100.0

Source: Field Survey

Preparation of financial reports by micro enterprises

The question of whether entities prepare financial statements revealed that 118 constituting 59 percent prepare financial reports while 82 representing 41 percent did not prepare financial reports. The study also showed that even those who prepare financial reports failed to follow the standards recommended by various regulatory authorities that exist for them. However, they insist that the accounting reports must be modified to suit the needs of small and micro enterprises.

Table 2 Preparation of Financial reports

	Frequency (in no.)	Percent (in %)	Valid Percent (%)
Prepare	118	59.0	59.0
Do not prepare	82	41.0	41.0
Total	200	100.0	100.0

Source: Field Survey

Person responsible for financial record keeping and preparing financial reports

Financial record keeping is technical and so requires a trained professional to do it. Without the needed skills and knowledge, it is difficult to write up good financial records for financial reports generation. On the question of the one responsible financial records keeping, it came to light that in majority of the entities, the financial records keeping was done by the business owners themselves. However few entities have an accountant and managers who do the financial record keeping.

Table 3 In-charge of record keeping

	Frequency (in no.)	Percent (in %)	Valid Percent (%)
Owner	119	59.5	59.5
Manager	22	11.0	70.5
Accountant	1	0.5	71.0

Sales personnel	2	1.0	72.0
Not prepared	56	28.0	100.0
Total	200	100.0	100.0

Source: Field Survey

Types of financial records kept by micro enterprises

For good financial record keeping practices, an enterprise must keep records on purchases, sales, earnings, receipts and payments. McChlery at el (2005) studied financial records keeping practices in small entities and concluded that financial records of SMEs should include “sales day book, purchase day book, cash receipt book, cheque payment book, petty cash book, general journal, nominal ledger, debtor’s ledger and creditor’s ledger”. The present study identifies the accounting records maintained by the Micro enterprises in Mizoram.

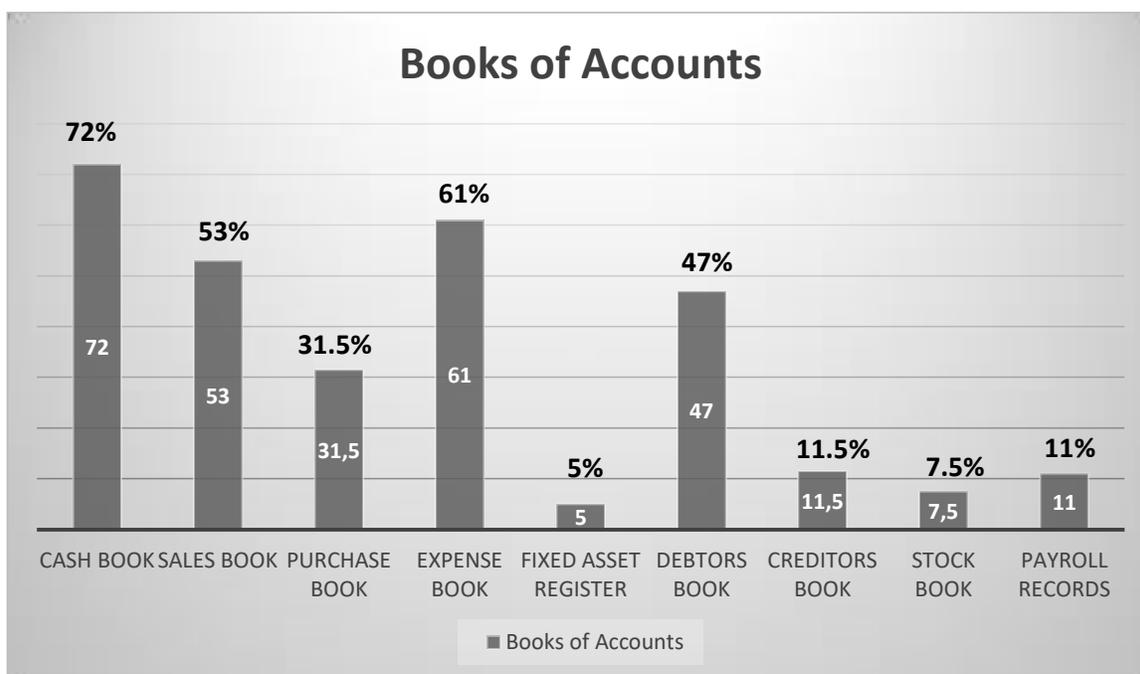


Figure 1 Financial records kept by micro enterprises

In terms with the type of financial records kept by the micro enterprises, it was found that out of 200 respondents 72 percent prepares Cash book, 53 percent of the entities keep Sales

book, 31.5 percent keep Purchase book, 61 percent of the micro enterprise prepares Expense book, only 5 percent of the entities keep fixed asset register, another 47 percent keep Debtor’s book, 11.5 percent only prepared Creditor’s book, while only 7.5 percent keep stock book for materials and 11 percent of the enterprises prepared Payroll records. From these findings it is clear that all small businesses keep some sort of financial records. However, no entity keeps complete set of financial records as prescribed by McClery at el. This consequently makes preparation of financial reports for good assessment of the business very difficult because accurate record keeping is the foundation for financial reports.

Types of Financial reports or Financial Statements prepared by the micro enterprises

On the issue of the type of financial reports prepared by Micro Enterprises in Mizoram, it was found that out of 200 respondents, 58 percent of the entities prepare Profit & Loss Account, 10 percent prepare Balance Sheet while only 2.5 percent prepare Cash Flow Statement. The summary of the findings is evidenced in figure 3.7 below

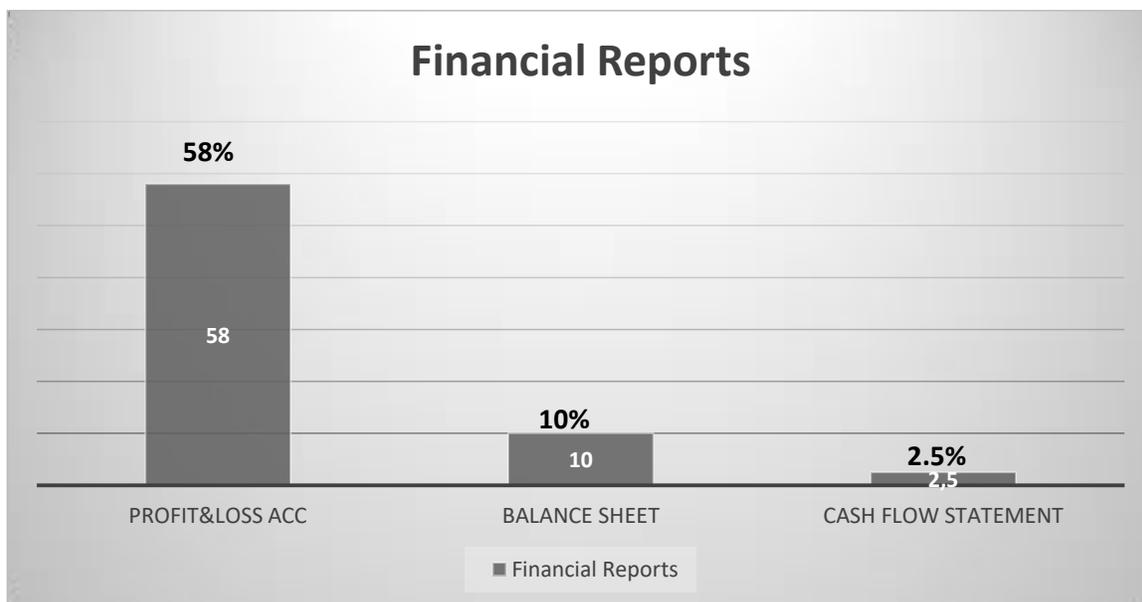


Figure 2 Financial report or financial statement prepared by the micro enterprises

Financial report preparation basis

The study presents the response on how often financial reports or statements are prepared by the micro enterprises in Mizoram. It was identified that 53.5 percent of respondents prepared financial reports on a monthly basis, whereas 5.5 percent did so on an annual basis. The data also showed that 41.0 percent of respondents do not prepare financial statements or reports.

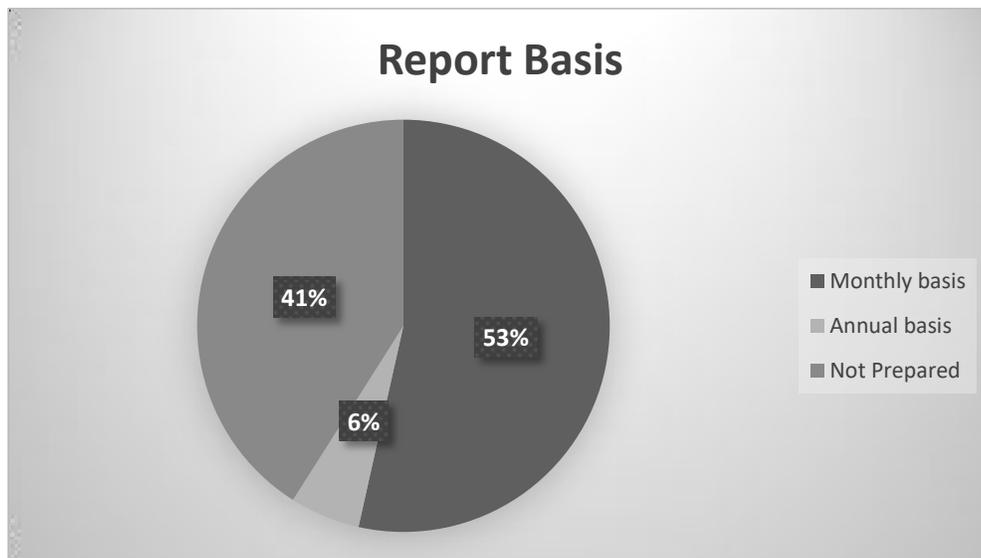


Figure 3 Basis of preparing financial report by the micro enterprises

Challenges faced by the micro enterprises in preparing Financial Reports

Financial reporting has immense benefits to small scale enterprises; it provides quick and relatively simple means of assessing the financial health of a business. Yet few entities practice it. Even those who practice it do so, on an ad hoc basis. The study revealed a number of challenges hindering micro enterprises from preparing financial reports.



Figure 4 Challenges face in preparing financial reports

On the issue of the challenges faced in preparing financial reports, the main challenge faced by the entrepreneurs was ‘it requires technical skills & knowledge’. Time constraints was also a big challenge in preparing financial reports as well as the need for more staffs since the owners were not capable to prepare complete financial reports. 122 respondents were also sceptical about preparing financial reports as they were afraid it would expose their financial position while 112 respondents said it is a boring repetitive concept to make record of their financial transactions. 104 entities said it is difficult to maintain the system as they lack accounting knowledge while 58 entities find it unnecessary and not important to prepare it. Out of 200 respondents, 77 micro enterprises said it is expensive to prepare financial reports as it requires time and involvement of professionals while only 22 percent said it makes their business to pay more tax when they produce their financial report to the taxation department.

Impact of not preparing Financial Reports

Businesses are required to keep proper books of account and prepare financial reports which give a true and fair view of the business’s financial affairs. Proper records and financial reports provide useful information regarding financial position of the business, the success of business operations, the effectiveness of policies and strategies and provide insight into future performance. Though financial reporting practices come with cost and challenges, the benefits derived from its practice far outweigh its cost. Businesses that disregard the importance of proper record keeping and financial reporting pay dearly for that. This study revealed some consequences of failing to prepare financial reports. Lack of keeping complete accounting records leads to minimum utilization of accounting information to support the measurement for financial performance by the small and micro enterprises. Also lack of keeping proper accounting records lead to difficulty in calculating business profit efficiently for the entrepreneurs (Madurapperuma, Thilakerathne & Manawadu, 2016).



Figure 5 Consequences of not preparing financial reports

The study revealed that the most prominent consequence of failing to prepare a financial report is inability to detect losses and theft in the business which is followed by difficulty in determining the results of operation and difficulty in determining the financial position. Other impacts of not preparing financial reports on descending basis were difficulty in assessing credit/finance and loans and inefficient, improper and untimely decision making.

4. CONCLUSION AND RECOMMENDATION

Conclusion drawn from the research indicated that major of the micro enterprises do not prepare complete financial reports as a result of poor records keeping, fear of exposing the business to danger if business information is made public, high cost associated with financial reporting and lack education on the importance of financial reporting to the business. This therefore, affects the ability of micro enterprises in access financial assistance both from the government and private institutions and in most cases a major cause of business failure. The research further revealed high level of illiteracy, in terms of basic financial records keeping and financial reporting, on the part of small business owners. Unfortunately, there is no training programmes organized by the Directorate of Commerce and Industries and other institutions, like district and state educational institutions, also neglect this important tool for business survival.

Due to the immense contribution of micro enterprises to the socio-economic development of the country as well as the state, much attention should be given to proper financial record keeping and financial reporting procedures in micro enterprises. The government of Mizoram and India is doing a lot to promote and sustain small businesses in the country yet little is done in terms of financial management especially financial reporting. It is therefore suggested that the central and state governments in collaboration with professionals and educational institutions embark on massive financial reporting education and training for the small business owners and help prepare their financial reports at a minimal fee if not for free.

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