

**The financial records, accounting and compliance reports of small business:
Evidence from Australia**

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Abstract

This paper examines the financial records and accounting and compliance reports kept by small businesses in Australia. While large incorporated companies must produce a number of accounting reports, small businesses do not face the same legislative requirements. Prior research has shown that there is little empirical evidence on the accounting records of small businesses and in the light of this, the present paper reports on the findings from 121 responses to a mail-out questionnaire. Results show software programs are widely used to record financial information. In terms of the accounting reports, the profit and loss report is most likely to be produced, and considered most useful. Given the use of accounting software and the involvement of professional accounting services, the lack of existence and use of accounting reports by small businesses is a concern.

Key words: Small businesses; accounting reports; financial records.

Introduction

Small businesses¹ make a significant contribution to the economy of all countries. In the UK for example small firms represent over 90% of the business population and provide nearly two-thirds of the national employment (Mitchell and Reid, 2000); in Norway small businesses represent about 95% of Norwegian firms (Gooderham, Tobiasen, Døving and Nordhaug, 2004); in the USA there are over 22 million small businesses employing over 50% of the private work force and these represent nearly 99% of all employers (United States Small Business Administration, 2005) and finally in Australia, it is estimated that there were over 1.2 million small businesses employing almost 3.6 million people, and represent 97% of all private sector businesses (ABS, 2002). In Australia small businesses dominate all industrial sectors although numbers are greater in the services sector in comparison to the manufacturing sector.

While entry into a small business is a simple process requiring an investment of individuals' resources, time and skills, remaining in business can be difficult. Research into small business has noted that one major impediment to continuing as a going concern is the owner's lack of financial skills, record keeping and understanding how to use financial information (Thomas and Evanson, 1987; Holmes and Nicholls, 1988; CPA Australia, 2003). Recently the compliance costs of taxation have also proven to be difficult for small businesses (see Chittenden, Kauser and Poutziouris, 2003; Lawson, 2005) and even the Australian Taxation Office (ATO) have noted that small businesses struggle to keep up to date with their record keeping (Lawson, 2005).

This paper investigates the record keeping, accounting and compliance reports of small businesses. While larger companies in Australia must by law produce general purpose accounting reports, small businesses (which are not incorporated) are not faced with the same accountability. Rather the accountability of small businesses lies in compliance with taxation requirements, not the production of accounting reports. This finding is interesting given that a large body of research exists on the usefulness of financial information and accounting reports for decision making (see for example Altman, 1968; Ball and Brown, 1968; Libby, 1975), and the link with small business success and record keeping.

The remainder of this paper proceeds as follows: In the next section the relevant literature is reviewed with regards to the benefits of record keeping and accounting reports to small business. The following section describes the methodology of the study. The results of the study are then presented and discussion and conclusion follows. Finally limitations and areas of further research are noted.

Literature Review

Current Australian legislation (the Corporations Act, 2001) requires that only incorporated businesses (that is, companies) are legally responsible for producing accounting general purpose reports. These general purpose reports include the Profit and Loss Statement, the Balance Sheet, the Cash Flow Statement and the Statement of Changes In Equity. These companies along with other reporting entities² are also required to comply with Accounting Standards and lodge with the Australian Securities and Investments Commission (ASIC) annual financial statements (Andrews, 2005). The Accounting Handbook (which outlines all Accounting Standards) further states in SAC 1 (paragraph 12) that individual reporting entities may be identified by reference to the existence of users who are dependant on general purpose financial reports for information for making and evaluating resource allocation decisions (CPA Australia, 2006).

In Australia it is estimated that 50% of small businesses are not incorporated (Senate, 2003) and therefore not obligated to comply with the Corporations Act (2001) and accounting standards in terms of producing accounting

¹ "Small businesses" are defined differently according to country. For instance in the UK a business is considered "small" if it employees less than 250 (Mitchell and Reid, 2000); in Norway small businesses usually employ between 1-19 employees (Gooderham et al., 2004); in North America small businesses employ fewer than 500 employees (Holmes, 2001); and in Australia small businesses employ less than 20 employees.

² SAC 1 defines a reporting entity as any legal, administrative or fiduciary arrangement, organisational structure or other party having a capacity to deploy scarce resources in order to achieve objectives (paragraph 6).

reports. Small businesses are not regarded as reporting entities because they do not have dependant users. Rather small businesses must comply with the ATO and submit Business Activity Statements (BAS) and annual income tax returns. On July 1, 2000 Australia introduced a Goods and Services Tax (GST) and the BAS is a product of this. In the BAS, small businesses self assess their taxation obligation through their record keeping of receipts and GST received, and payments and GST paid. BAS's must be returned to the ATO either monthly or quarterly in addition to the annual taxation returns - the timing being dependent on how the small business registered for the GST, and business size.

Petzke and Murphy (2001) examined the impact of the GST on small business, and noted that the GST was extremely costly both financially and in time. CPA Australia (CPA Australia, 2003) also found that because of GST compliance, the role and volume of assistance provided by the accountancy profession to small business had increased resulting in increased costs. Breen, Sciulli and Calvert (2004) further stated that the GST has led to increases in the use of accounting software by small businesses. CPA Australia however noted that the GST also led to an incentive to keep up-to-date with record keeping and produce reports regularly (CPA Australia, 2003). Carey, Simnett and Tanewski (2005) reported that 97% of SMEs (any business which employs between 5 and 200 employees) purchase some accounting and/or advisory services from their external accountants, and these services are largely designed to satisfy taxation requirements.

With respect to the usefulness of financial record keeping by small business, McMahon and Holmes (1991) stated that the clearest and most startling distinctions between successful and discontinued small businesses lie in their approach to the uses which can be made of accounting information. The authors stated "that sound financial management is crucial to the survival and well-being of small enterprises of all types" (McMahon and Holmes, 1991:19). McMahon (1999; 2001a; 2001b; 2003) examined the record keeping by small businesses and noted that general purpose reports were useful as performance measurements (see also Argilés and Slof, 2003 in relation to small businesses in the agricultural sector). This supports seminal research focusing on the production and usefulness of accounting reports for businesses generally (Altman, 1968; Ball and Brown, 1968; Libby, 1975; and also see Sharma and Iselin, 2003 for summaries of other studies). While business success can in some way be assisted by good financial management, reasons for small business failure inevitably show poor or careless financial management to be the most important cause (see McMahon, 2001a; 2001b; McMahon and Davies, 1994; McMahon and Holmes, 1991).

Even though prior research has recognized accounting reports as being useful, only a small number of studies have focused on identifying the reports of small businesses. For instance in a survey of 360 small businesses in Georgia, USA, DeThomas and Fredenberger (1985) stated that 81% of small businesses produced summary financial reports and of those, 91% produced general purpose reports. Further the authors found that only 11% used financial statement information in their managerial evaluation and 2% performed financial ratio analysis - even though 61% felt the information could be used for planning and decision making. In a further USA study, Thomas and Evanson (1987) examined 398 small pharmacies and found that 62.5% produced quarterly (at least) profit and loss and balance sheet statements, and over 85% outsourced the statement preparation to accountants. The authors noted that useful information included ratio calculation and the balance sheet was helpful in relation to business performance (Thomas and Evanson, 1987). Jennings and Beaver (1997) provided a summary on the relationship between small business and success and stated that accountancy measures such as profitability, cash-flow, and ratio analysis were effective measures (see also Hall and Fulshaw, 1993).

Aims of the present study

The dearth of research examining accounting reports in the Australian context is interesting given the importance placed on prudent financial management by small businesses generally (McMahon, 2001a; 2001b; McMahon and Davies, 1994; McMahon and Holmes, 1991; Argilés and Slof, 2003; Thomas and Evanson, 1987; Holmes and Nicholls, 1988; CPA Australia, 2003; Chittenden et al., 2003; Lawson, 2005). Noting the lack of empirical research, the key issue being addressed in the present study is to identify the financial records and accounting and compliance reports kept by Australian small businesses. Currently the only reports needed to be produced by small businesses are those that comply with the ATO, and taxation law simply requires records which "record and explain" business transactions (ATO, 2002). As a result, accounting records could be as basic as a collection of receipts and cheque butts (often referred to as 'shoe box' accounting) or as sophisticated as a computerized accounting package such as Mind Your Own Business (MYOB) or QuickBooks. CPA Australia noted that accounting professionals are being

used more by small business to assist with record keeping and compliance (See CPA Australia, 2003) and this issue also will also be examined in the current study.

Methodology

The present study adopted the questionnaire and survey approach to data collection. Prior to the final development of the questionnaire, semi structured interviews were held with two small business owners regarding their financial record keeping and accounting reports. In these interviews the researcher provided the owners with a draft questionnaire to complete. This enabled the researcher to consider any language or interpretation issues and address these as they were raised. Using this data and prior literature, a final questionnaire was developed to gauge wider understanding on the nature and type of accounting information kept by small businesses. The questionnaire was divided into three sections. Section one was concerned with demographic data on the small business including the length of ownership, age of business, number of employees and annual business turnover. Section two examined the nature and type of financial records, accounting and compliance reports kept. Finally, section three examined the usefulness of financial records and accounting and compliance reports.

The questionnaire was mailed to a random sample of one thousand small businesses selected from regional towns in Gippsland in the state of Victoria.³ Names and addresses were obtained from public business phone records via the Telstra White Pages (Telstra, 2003). Businesses were selected randomly from each major town in Gippsland so that the sample was representative of the area. The mail was addressed to the owner of the business. While the Telstra White Pages are updated yearly, a limitation of using this source is that due to the dynamic nature of the small business sector, these records may not be an accurate listing of all businesses operating at that time.

An explanatory statement accompanied the questionnaire which stated the aim and purpose of the study. The explanatory statement instructed the survey to be completed by the owner and for this to be returned in the reply paid envelope. Because of University ethics regulations, participation in the survey was completely voluntary and this was made clear on the explanatory statement. After two weeks a follow-up was sent to all non responding businesses.

From the total number of questionnaires 103 were returned to sender, and not followed up. Of the replies, 121 were useable representing a response rate of 14%. While the response rate was quite small, information was still considered useful as the number of responses is quite large ($n = 121$) given the limited research in the area. Dennis (2003) noted that mail surveys of small businesses have notoriously low response rates with over a third of published articles on small businesses having a response rate of lower than 25%. In the present study there is no indication of non-response errors, and demographic data shows the data is representative of the population being assessed.

Results

Quantitative procedures were used to analyse the data on the forced-choice questions.

In terms of demographics, of the total sample, 8% ($n = 9$) of the businesses were aged between 0 and 5 years; 18% ($n = 22$) 5 to 10 years; 31% ($n = 37$) 10 to 20 years; 41% ($n = 50$) were aged 20 years or more; and 2% were not sure ($n = 3$). The majority of these businesses 83% ($n = 100$) operated from one physical location. In terms of the length of time the current owner had been running the business 15% ($n = 18$) stated they had been operating for between 0 and 5 years; 20% ($n = 24$) between 5 and 10 years; 27% ($n = 33$) between and 10 and 20 years; 22% ($n = 27$) for 20 years or more; and 16% ($n = 19$) did not answer this question. In terms of the number of employees, 69% ($n = 84$) stated they employed between 0 and 4 Equivalent Full Time employees; 20% ($n = 24$) had between 5 and 9; 7% ($n = 8$) between 10 and 19 employees; and 4% ($n = 5$) did not answer this question. In respect of business turnover, 24% ($n = 29$) stated the range was between \$0 and \$100, 000; 41% ($n = 49$) between \$100,000 and \$500, 000; 19% ($n = 23$) between \$500,000 and \$1,000,000; 10% ($n = 12$) \$1,000,000 and above; and 6% ($n = 8$) were unsure or did not answer this question. In terms of maintaining business records, 97% of owners stated they did this themselves.

³ According to the Australian Bureau of Statistics, Victoria accounts for approximately 24% of the 1.2 million private sector small businesses in Australia (ABS, 2002).

A question investigated how receipts and payments are recorded. More than one answer was allowed from a list provided (this resulted in N being greater than the total sample). Table 1 shows the results, and that accounting software is widely used.

	Recording receipts (N)	Record of payments (N)
Did not attempt	5	4
Receipt book	35	N/A
Cheque butt	N/A	83
Exercise/Memo book	6	10
Cash register	25	N/A
Cash book/Accounting printed book	23	20
Accounting software	86	77
Total	180	194

Table 1: The financial records for recording receipts and payments

The next question examined the sources for completing taxation compliance reports. Table 2 shows more business owners complete the BAS, while the accountant more often prepares the annual taxation return.

	Who completes the BAS		Who completes annual taxation return	
	Total	%	Total	%
Not attempted	2	2	5	4
Business	70	58	11	9
Accountant	37	31	105	87
Outside	7	6		
BAS not needed ⁴	5	4		
Total	121	100	121	100

Table 2: The producer of compliance reports by small businesses

The next question examined the accounting reports produced by small businesses. Table 3 shows the profit and loss statement is more likely to be produced than a balance sheet or cash flow statement.

Accounting reports produced	Yes		No	
	N	%	N	%
Profit and Loss	84	69	37	31
Balance Sheet	64	53	57	47
Cash Flow	43	36	78	64

Table 3: Accounting reports produced by small businesses

The survey then asked owners to rate the usefulness or otherwise of the accounting and compliance reports. This was a forced choice question answered on likert scale where 1 = not useful, 2 = useful, and 3 = very useful. Table 4 shows that the profit and loss report was rated the most useful report, and the balance sheet and cash flow useful to varying degrees. The BAS was found to be the least useful statement.

Type of Report	Total Responses	Mean	Standard Deviation
Profit and Loss	109	2.54	.570
Balance Sheet	99	2.16	.681
Cash Flow	91	2.38	.628
BAS	108	1.78	.688
Annual Tax Return	107	2.21	.683

Table 4: Mean and Standard deviations evaluating the usefulness of accounting and compliance reports (note that higher mean values indicate the more useful report. 1 = not useful, 2 = useful, and 3 = very useful)

⁴ Businesses not registered for GST or with annual income turnover less than \$50,000 are not required to produce BAS reports.

The respondents in Table 4 were analysed based on whether the business had produced accounting reports or not (see Table 5). Table 5 shows there are no significant differences in the mean responses for accounting report usefulness between businesses with accounting reports and those businesses that do not have those reports. This indicates that some businesses view the accounting reports as useful even though they may not have these reports.⁵

Type of Report	Have Accounting Reports			Do not have Accounting Reports			'p' value
	N	Mean	Standard Deviation	N	Mean	Standard Deviation	
Profit and Loss	84	2.58	.564	24	2.38	.576	.115
Balance Sheet	62	2.24	.645	37	2.03	.726	.129
Cash Flow	39	2.51	.601	51	2.27	.635	.074

Table 5: Mean and Standard deviations evaluating the usefulness of accounting reports for business with and without accounting reports (note that higher mean values indicate the more useful report. 1 = not useful, 2 = useful, and 3 = very useful).

The final question asked owners their views on how they knew their business was performing. This was a forced choice question where a number of alternatives were provided, and respondents were asked to tick one. Table 6 shows that the most popular response was "knowing money in the bank" followed by 'performance evaluation using financial statements and financial information'.

	Total N
Money in bank	37
Performance evaluation	30
Knowledgeable guess	22
Just know	9
Gut feel	7
From other business location	11
Did not attempt	5
Total	121

Table 6: Affirmations of how businesses know how they are performing

Discussion and Conclusion

The purpose of this paper was to explore the financial records and accounting and compliance reports produced by small businesses. While it is well known that financial information is linked with the success (and failure) of a business, there is little information examining what are the actual accounting reports of small businesses in Australia.

The present survey found that 97% of small businesses maintain their records and it is from these records that financial information is gathered. When recording receipts and payments an accounting software package is widely used. Most small businesses (87%) used the services of an accountant to prepare the annual taxation reports, confirming that the accounting profession is heavily involved in small businesses (see CPA Australia, 2003; Carey, Simnett and Tanewski, 2005). Interestingly this study found that the business owner is more likely to produce the BAS than the accountant. The study found that the most useful accounting report was the Profit and Loss. Interestingly owners who did not produce accounting reports also rated these as useful and that there is no significant difference between the usefulness ratings (see Table 5).

The findings of the present study assist in explaining what small businesses are doing with respect to financial recording, accounting and compliance reports. While most small businesses produced a profit and loss report, the lack of accounting reports is generally a concern particularly given the existence of accounting software programs

⁵ Only businesses that responded to the question on the usefulness of financial statements are considered in this analysis.

that can easily produce accounting reports, and wide use made of professional service accountants. The reasons for this should be explored in future research. The fact that most small businesses owners produce the BAS is worthy of note, given that this was rated the least useful report. There is perhaps a role for Governments and small businesses advisers here to make business owners more aware of the greater usefulness of the BAS report, given that is sometimes produced monthly, or at least quarterly (CPA Australia, 2003).

Further research could also be undertaken on the examining the responses to table 6. Given that businesses spend a great deal of time and money collecting and recording financial information, have accounting software and make use of the professional services of accountants, performance is most often evaluated by "having money in the bank". Perhaps another methodology approach such as in depth interview could gain a greater insight into how small businesses evaluate performance (given the low response rate by traditional mail out surveys).

While this study has gathered some useful data, it is not without its limitations - the low response rate being one. Even though the response rate was low, the sample was representative of the population. Any response rate using small businesses however could be criticized especially as there are over 1.2 million small businesses in Australia. While the number of responses received from the sample population does not allow generalizations about small business recording and reporting, it at least provides some insightful information particularly as demographic information was well represented. Like any type of research, further studies should be undertaken to see if these results are similar to other samples.

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