

FINANCIAL REPORTING PRACTICES OF SMALL AND MEDIUM ENTERPRISES (SMEs) IN SRI LANKA

U.A.H.A. Rathnasiri

Department of Accountancy, Faculty of Commerce & Management Studies, University of Kelaniya, Sri Lanka

Email: hashika@kln.ac.lk

ABSTRACT

Small and medium enterprises (SMEs) play an important role in any economy as they are capable of generating employments, promoting the growth of Gross Domestic Product (GDP), embarking on innovations and stimulating of other economic activities. Empirical results emphasized that better financial information means better control and higher chance of success and good record keeping, the types of records maintained and management's understanding of the information could be correlated with business success on one hand or the resistance to failure on the other. Therefore, prudent financial management practices and reporting skills are paramount important for the wellbeing of SMEs and to strengthen their economic and social contribution.

This research is attempted to explore whether and to what extent Sri Lankan Small and medium enterprises (SMEs) adopt financial reporting practices and how such practices are incorporated with prevailing information systems. Determining the population of SMEs in Sri Lanka is imprecise. Considering the number of establishments, availability of data, time constraints etc the researcher selected the target sample of 60 SMEs which are registered in the Ministry of Industry and Commerce (MIC) within the period of year 2008 to 2013, operating their businesses in the manufacturing sector and the study is limited to the western province in Sri Lanka. A questionnaire was chosen as a data collection instrument. The sample has collected by using disproportionate stratified random sampling design by using Statistical Package for Social Science (SPSS) software (PASW 18). Data was not normally distributed, non-parametric statistical tests were conducted. Calculations of averages, frequency distribution, cross tabulations and percentage distribution used as the tools of descriptive analysis.

Analysis of the study reveals that SMEs pay more consideration in preparation and monitoring of three components of financial statements balance sheet, statement of profit and loss account and cash flow statement. Thus Sri Lankan SMEs prepare the reports which help the owner/managers to control the financial position and performance of the business. Results demonstrated that the highest importance is placed on preparation and monitoring of cash flows of the businesses which is critical to the success and survival of SMEs. But most of the SMEs have maintained the informal accounting systems and lack of comprehensive set of financial reports. SMEs in Sri Lanka must cope with the uncertainty of the business environment, therefore up to date financial information for decision making is paramount importance.

It is recommended policy makers to consider SMEs under a single ministry and stipulate specific, consistent policy focusing on the development of the sector addressing the core constraints inhibiting the growth of the sector. Further educating SME owner/managers about the importance of prudent financial management practices for the long term success and survival is vital.

Keywords: Small and medium enterprises, financial management practices, financial reporting practices, Sri Lanka.

1.1 INTRODUCTION

The Small and Medium Enterprise sector is said to be the backbone of all developed and developing nations. According to a study by Shandong University of Technology in China, 60-80% of new jobs are created solely by the SME sector annually and in Europe, 75% of the workforce is employed by SMEs. In Korea, SMEs represent 99% of the total number of companies and corresponded to 43% of the country's exports.

The development role of SME sector in developing countries has been highly recognized. They serve as engines through which the growth objectives of developing countries can be achieved. SMEs are necessary engines for achieving national development goals such as economic growth, poverty alleviation, democratization and economic participation, employment creation, strengthening the industrial base and local production structure (Abeygunasekera & Fonseka 2012).

The SME sector would become an important aspect for developing countries as they are generally burdened by poverty and unemployment problems. Further, it has been noted that the SME sector has become a crucial as well as a major section of private sector in developing countries (MED 2002). Therefore, it could be argued that Sri Lanka can gain economic benefits by developing SME sector.

Successive governments in Sri Lanka have taken various steps, to promote this sector since independence though the outcome has not been properly measured. With reference to the available information it is clear that the present contribution to the economy from SMEs is not at a satisfactory level. Thus there is a great need of study about the SME sector in developing arena and harness the full potential of the SME sector.

SMEs make up a large part of Sri Lanka's economy, accounting for 80% of all businesses. These are found in all sectors of the economy, primary, secondary and tertiary and provide employment for persons of different skills, skilled, semi-skilled and unskilled. It is noted that, 20% of industrial establishments fall into the SME group, while in the service sector their share is over

90%. And also SMEs are an essential source of employment opportunities and are estimated to contribute about 35% of employment (Secretariat 2012).

The present government also considers SMEs as an important sector in the economy and as a result it is stick to continue its' efforts to promote the SMEs with a view to create more employment opportunities and to generate income. The Mahinda Chinthana Plan (2006-2016), the current framework for macroeconomic policy, strives for the development of a competitive, innovative and technologically driven SME sector, which is capable of meeting the increasing demands of globalization and intensifying competition.

The government budget 2011 has also proposed to provide relief to SMEs that were adversely affected during the global financial crisis (Annual report 2011). Accordingly, significant tax exemptions and concessions were granted (PWC 2012). Although SMEs role in the economy is substantial, many of them are plaque by management problems (Hashim and Wafa 2002). These management problems include financial management, human resource management, marketing management, operations management, strategic management etc. Given that financial management is one of the key aspects of the well being and survival of a business and it is a managerial activity concerned with the planning and controlling of the firm's financial resources (Pandey 2004).

SMEs often encounter accounting and financial management challenges due to poor record keeping, inefficient use of accounting information in financial decision making and the low quality and reliability of financial data (Sarapaivanich 2003). Also proper accounting is useful in making sound economic decisions which are vital for the success of small businesses. The misuse and untimely, poorly recorded and inaccurate accounting information leads SMEs to assess their financial situation inaccurately and make poor financial decisions. In the worst case, SMEs might fail and perhaps bankrupt at the end (Stice et al. 1999). These short comings might be the cause difficulties in succeeding and raising funds or borrowing money. The shortage of capital due to number of reasons such as lack of access to bank facilities, lack of knowledge of bank procedures, long delays in obtaining credit and inability to provide guarantees are major problems faced by the SMEs (Gamage 2000).

Empirical results emphasized that better financial information means better control and higher chance of success and good record keeping, the types of records maintained and management's understanding of the information could be correlated with business success on one hand or the resistance to failure on the other. Therefore, prudent financial reporting practices is paramount important for the wellbeing of SMEs and to strengthen their economic and social contribution.

1.2 PROBLEM IDENTIFICATION

Small and Medium Enterprises play an important role in both developed and developing countries. They contribute to the growth of the economy in many ways such as employment generation, new venture development and opening up new avenues for the growth in the economy. However, evidence has been found that there are many failure of SMEs in Sri Lanka and the Central Bank of Sri Lanka (1998) stated that inadequate capital, inadequate institutional credit facilities, use of outdated technology, improper accounting techniques, inadequate sales, promotion competencies and inattentiveness of small businesses are the main problems faced by the Sri Lankan SME sector.

According to studies conducted by multilateral and bilateral agencies such as USAID, World Bank, JICA, ADB and UNIDO; it is found that high interest rates and the need of keeping collateral by the borrowers are common constraints faced by Sri Lankan SMEs (Gamage 2000). Further, the financing has become a big challenge, even though the state owned banks and other development financial institutions have taken various measures to assist SMEs in providing finances over the period of time (NEDA 2011). The inability of SMEs to find their counter funds requirement as a condition of financial arrangements creates another barrier for SMEs to enjoy the facilities offered in concessionary finances. Also the availability of detailed statements that are comparable among companies is a fundamental pre requisite for credit lenders to build a thorough and robust analysis of the creditworthiness of a business (Abeygunasekera & Fonseka 2012).

These obstacles are resulted from inefficient business administration, lack of experiences in some important business functions, especially accounting and finance. Several studies highlighted that, poor accounting practices as one of the factors contributing to the failure of SMEs. Huck & McEwen (1991) argue that, finance and accounting as one of the twelve competency areas for small business success.

Having identified the importance of financial reporting, The Institute of Chartered Accountants of Sri Lanka introduced a separate standard for SMEs and IFRS for SMEs effect from 1st January 2012 with the intention of providing prudent financial information to the users of financial statements of SMEs (E&Y 2012). Thus prudent financial management practices could help Sri Lankan SMEs to plan and control their operations in order to achieve company goals and the long term success and survival of the businesses (Abeygunasekera & Fonseka 2012).

Therefore, the central research question of the study was set as, whether and to what extent Sri Lankan SMEs adopt financial reporting practices and how they are incorporated with prevailing information systems.

Research objective of the study is,

To identify what financial reporting practices are used by SMEs in decision making.

- To examine the nature and structure of financial statements prepared by SMEs.

1.3 SIGNIFICANCE OF THE STUDY

There is a dearth of studies focused on the adoption of financial reporting practices for small and medium enterprises in developing economies like Sri Lanka. This study focused insight into the adoption of different financial reporting practices of SMEs in Sri Lanka

Most of the research studies had proven that problems related to finance as the critical and foremost reason for increasing the failure rate of SMEs. The weak financial base may basis to other problems like upgrading of technology, expansion of production capacity, production efficiency, lack of access to bank facilities etc.

On the other hand, many studies proved the fact that sound financial reporting practices not only control the financial position but also significantly contribute to improving and increasing profitability of SMEs.

There is a compliance requirement that Institute of Chartered Accountants of Sri Lanka has decided to adopt the International Financial Reporting Standards for SMEs as the Sri Lanka Financial Reporting Standards with effect from 1st January 2012. This means that SMEs can comply with statutory requirement of presenting financial statements (E&Y 2012). Though there is a compliance requirement about presentation of financial statements, there is no any monitoring mechanism to assess the adherence to that. This study attempts to monitor that requirement up to certain extent.

2.1 SAMPLE AND POPULATION

Determining the population of SMEs in Sri Lanka is imprecise. All the existing data sources lack accuracy and complete coverage of sector wise SMEs in spite of various government and semi-government institutions engaged in compiling SME related databases. Thus there is no centralized database available representing wide spectrum of areas that SMEs are operating like manufacturing, agriculture, mining, construction, service etc.

Therefore considering the number of establishments, availability of data, time constraints etc the researcher intends to select the target sample of 100 SMEs which are operating their businesses in the manufacturing sector and the study is limited to the western province in Sri Lanka. Among the wide range of enterprises that are functioning in Sri Lanka, the manufacturing sector is an important economic sub sector because its activities tend to draw support of enterprises in other sectors that produce or provide inputs and services (National Policy Declaration on Enterprise Development 2009). Out of all SMEs, 73% represent manufacturing related enterprises (Gamage 2013). Also it is noted that within the manufacturing sector SMEs account for 96% of industrial units (MED 2002).

The western province is selected for the research as more number of establishments represents the western province (DCS 2009). Except for the more number of establishments, it is stated that around 65% of value addition generates from the manufacturing enterprises established in the western province.

Due to the absence of a nationally accepted definition for SMEs and the unavailability of information, researcher intends to consider about the World Bank definition. According to that definition, there are three bases to classify the SMEs namely, Micro, Small and Medium. i.e. employment, total assets and total annual sales. Out of the World Bank definition, researcher considered only the employment base to define SME for the study purpose. Employment base is the most widely used measure of size in quantitative definitions of small enterprises around the world (McMahon et al. 1993). Accordingly, the researcher uses the following definition for SMEs demarcating micro, small and medium enterprises.

Micro - Up to 10 employees

Small – Up to 50 employees (10-50)

Medium - Up to 300 employees (50-300)

Considering the availability of up to date information of SMEs, reliability of data and number of years establishment of database, researcher intends to select the database belongs to the Ministry of Industry and Commerce (MIC). It plays a dynamic role in the development of the industrial sector and the line Ministry which is responsible for promoting industrial development in the country (<http://www.industry.gov.lk>).

2.2 DATA COLLECTION

Data were collected through a structured questionnaire sent to the manufacturing SMEs, which have been registered in the MIC and conduct their operations within the limits of western province. The considered registration period in MIC is from year 2008 to 2013. The questionnaire contains 28 questions and it mainly classified into two sections namely, part A and part B.

Out of the sample, randomly selected 15 small and medium enterprises considered to do a pilot survey. The study commenced with a pilot survey by e-mailing the questionnaire to a selected sample with the previous agreement by telephone conversation. The practical difficulty I found in the pilot survey is that, though several reminders have made responding to the questionnaire via e-mail, non-response rate was high even after a considerable time period. Thus the researcher personally visited most of SMEs, while explaining the questionnaire and getting responses.

The target sample of the study is 100 respondents. But due to the problems encountered in data collection, for an example, certain SMEs have change their locations, contact details are not functioning, unwillingness to disclose the data etc., the sample

was limited to 60 respondents. Respondents were assured anonymity and confidentiality of the responses and emphasis that there were no potential risks and cost involvement for taxation purpose. Sample has selected from MIC database within the period of registration from year 2008 to 2013.

The sample has collected by using disproportionate stratified random sampling design by using Statistical Package for Social Science (SPSS) software (PASW 18). The population of manufacturing SMEs segregates into three different strata namely Colombo, Gampaha and Kalutara.

Table 1: Selected sample of the study

	Colombo	Gampaha	Kalutara	Total
Register in MIC	170	76	25	271
Target sample	50	35	15	100
Selected sample	26	19	15	60

Source : Author compiled

2.3 OPERATIONALISATION

Financial Reporting Practices	Accounting information system <ul style="list-style-type: none"> - Recording business transactions - Preparing accounting reports - Interpreting and using accounting information in decision making - Extent of computer utilization in maintaining accounting information
	Financial reporting and analysis <ul style="list-style-type: none"> - Types of financial statements that SMEs are prepare, frequency and ranking the financial statements based on the order of importance - Purposes of preparing financial statements

Accounting information systems

In this study, accounting information systems included all systems of recording transactions, bookkeeping and use of computers in financial record keeping for management decision-making. Under that attitude of owner/manager to accounting information systems, owner/manager involvement in preparing accounting information, owner/manager involvement in the interpretation and use of accounting information, usefulness of accounting information in decision making, extent of computerization of accounting information etc.

Peacock (1988) found a significant element in the failure in many small businesses was inefficient or absence of accounting records. More than half of the businesses failed were found to have no records or only basic bank and taxation records. These findings prove that the importance of examining the impact of accounting information practices on small and medium enterprises.

Financial reporting and analysis

Book keeping alone without preparing reports is likely not to be fundamental in aiding decision making unless proper reports are prepared and analyzed to attach a meaning so as to help decision makers.

McMahon (1998) stated financial reporting and analysis includes the nature, frequency and purpose of financial reporting, audit, analysis and interpretation of financial statements, and use of physical and financial performance benchmarks.

The research conducted by DeThomas & Fredenberger (1985) found that, 81 percent of the small enterprises regularly obtained summary financial information. Ninety-one percent of the summary information was in the form of traditional financial statements (balance sheets, profit and loss statements, fund statements), the remainder being bank reconciliation and operating summaries whereas no business was regularly receiving cash-flow information. The study further found that 61 percent of respondents felt the financial statements provided the information they required for planning and decision making. Nevertheless, only 11 percent of respondents reported that they had used financial statement information formally as part of managerial evaluation, planning and decision making.

2.4 DATA ANALYSING TECHNIQUES

This study is basically an empirical nature as the use of descriptive statistics help to analyze the collected data in a manner in which any layman could able to understand and interpret the findings of the study. That refers to the transformation of the raw data into a form that will make them easy to understand and interpret. In this study calculations of averages, frequency distribution, cross tabulations and percentage distribution were used as the tools of descriptive analysis in order to examine the objective of the study.

3.1 ANALYSIS AND DISCUSSION

Descriptive statistics were applied to investigate and describe personal & business characteristics of SMEs.

3.1.1. Demographic and Business characteristics

The exploration of financial management tools and techniques in this study included the male-female distinction, education background, location of the business, size of the business, legal form, number of years in operations of the current business, debt/equity composition of capital etc. These characteristics help to understand the nature of the small and medium enterprises in Sri Lankan context with reference to the selected sample of the study. Table 2 gives a summary of descriptive statistics pertaining to different demographic and business characteristics of the selected sample of SMEs.

Table 2: Demographic and Business characteristics of the selected sample of SMEs

Characteristics	Frequency	Percentage
Gender		
Male	57	95%
Female	03	5%
Position of the Business		
Owner is separate from the manager	42	70%
Both Owner & Manager is one individual	18	30%
No. of years in operations of the current business		
< 1 year	01	1%
2 – 4 years	07	12%
5 -7 years	21	35%
> 8 years	31	52%
Education		
Below A/L	05	8%
A/L or above	55	92%
Professional and other required Qualifications		
Yes	18	30%
No	42	70%
Legal Form		
Sole-proprietorship	17	28%
Private Limited Company	43	72%
Size of the business		
Small	16	27%
Medium	44	73%
Location		
Colombo District	26	43%
Gampaha District	19	32%
Kalutara District	15	25%
Leverage between debt/equity		
Debt capital > 50%	45	75%
Equity capital > 50%	15	25%

Source : Author Compiled

3.1.2. Descriptive statistics on financial reporting practices

Accounting Information System

Under the dependent variable of Accounting Information System, respondents were requested to mention the extent of computer utilisation in the accounting process. Descriptive statistics are given in table 3 below.

Table 3: Computer utilisation in accounting practices

Legal Form	Computer utilization in the accounting process				Total
	Never	Rarely	Some times	Always	
Sole-proprietorship	6	3	1	7	17
Private Limited Company	2	0	9	32	43

Source : Author Compiled

Table 3 shows that, the use of computers in accounting applications in private limited SMEs are more than that of SMEs operating as sole proprietorships. SMEs operate as sole proprietorship are more responsive towards the manual recording of the business transactions and most of them are responded that accounting information are more or less important for them to day today running the businesses rather considering them to make business decisions for future business planning. In contrast to that, most of the SMEs operate as private limited companies, responded the usefulness of accounting information as decision making purpose and future business planning.

Around 70% of respondents mentioned that they utilise computers to conduct their accounting related transactions in businesses. Following table shows the type of operations for which computers are used and the corresponding percentages that SMEs use of computers.

Table 4 : Computer utilisation

Financial management practice	Percentage of SMEs
Recording business transactions	80%
Preparing financial statements and management reports	75%
Asset management	35%
Controlling payroll	3.3%
Controlling cash flow	70%

Source : Author Compiled

Table 4 shows that SMEs widely utilise the computers in order to record their day today business transactions, preparation of financial statements and mangement reports and cashflow management activities representing more than 70%. Percentage analysis showed that 80% of SMEs are used the computers to record the business transactions. SMEs pay less concern about utilising computers in asset management as well as controlling payroll activities. The least attention of utilising computers is for the control of payroll transactions which is around 3% of businesses. 70% of repondents are utilised the computers for controlling the cash flow of the business. Thus it is evident that SMEs are more concerned about the cash management practices. Around 75% of respondents mentioned that they utilise computers for the purpose of prepration of accounting reports.

Though SMEs do not maintain sophisticated accounting systems and softwares in accounting, they utilise computers for what ever they do related to accounting.

Financial Reporting and Analysis

Book keeping alone without preparing reports is likely not to be fundamental in aiding decision making unless proper reports are prepared and analyzed to attach a meaning so as to help decision makers.

The literature suggests that the financial reporting practices in small firms range from informal tacit methods of control to more formal delegated methods as precribed in accounting texts. Therefore, respondents were asked to identify the relative importance of most widely used components of financial statements and the frequency of preparing and monitoring of such financial information for management decision making.

Table 5 showed, the frequency of utilizing the different components of financial statements for management. Balance sheet, statement of profit and loss account, cash flow statement, changes in equity statement and bank reconciliation were the identified key components of financial statements. Based on the percentage analysis of different components of financial statements, the relative frequency was determined. The frequency was measured in four levels of preparation and monitoring of each component of financial statement i.e yearly, monthly, quarterly basis and if SMEs do not prepare needs to be mentioned as never.

The selected sample of SMEs prepare and monitor balance sheet and statement of profit and loss account on monthly basis representing 37% and 58% respectively. This demonstrates that SMEs strongly favour to prepare the reports which help the owner/managers to control financial position and performance of the business. The highest percentage of 60% reflected the importance placed on for the preparation and monitoring of cash flow statement by SMEs. As far as changes in equity statement and bank reconciliation are concerned highest percentage represented that they do not prepare these two statements for management decision making purpose. The results of the study demonstrated that, the cash flow statement is the most frequently utilised component of financial statement by SMEs which is critical to the success and survival of SMEs. The findings of the

study visualised the importance of awareness of Sri Lankan SMEs about the preparation and monitoring of changes in equity statement and bank reconciliation.

Table 5: The frequency of utilizing the components of financial statements

Components of financial statements	Percentage	Frequency
Balance sheet	37%	Monthly
Statement of profit and loss	58%	Monthly
Statement of cash flow (cash book)	60%	Monthly
Changes in equity statement	52%	Never
Bank Reconciliation	48%	Never

Source : Author Compiled

To identify the perceived importance that SMEs pay on different components of financial statements, respondents were asked to rank the components of financial statements based on the order they think as important in financial information for decision making purpose. Ranking 1 as the most important component of financial statement and ranking 5 as the least important component of financial statement based on the order of importance.

Table 6: Ranking of components of financial statements based on the importance for decision making purpose

Financial statement	Most Important					Least Important	Total
	Ranking 1	Ranking 2	Ranking 3	Ranking 4	Ranking 5		
Balance sheet	16%	67%	17%	-	-	100%	
Statement of profit & loss	62%	28%	10%	-	-	100%	
Statement of cash flow	23%	2%	71%	4%	-	100%	
Changes in equity statement	-	-	3%	49%	48%	100%	
Bank Reconciliation	-	-	3%	47%	50%	100%	

Source : Author Compiled

Table 6 showed that, the top three most important component of financial statements are belong to financial accounts rather than management accounts which are balance sheet, statement of profit & loss account and cash flow statement. Statement of profit & loss account is at the first order of importance denoted ranking number 1 representing 62%. SMEs perceive balance sheet as the second order of importance amounting to 67%. Third ranking or the importance goes to the cash flow statement representing 71% which is the highest percentage out of all three financial statements. Nevertheless changes in equity statement and bank reconciliation were given the least importance and such financial information were given a negligible importance by SMEs. Almost half of the respondents stated that the changes in equity statement and bank reconciliation as the least priority in decision making purpose. Though there were least priority towards the bank reconciliation, it is important to reconcile internal records with bank records as a means by which liquidity can be monitored (Jarvis et al. 2000) as well as contributing to the management of relations with the bank, the prime lender to small businesses (Chittenden, Mcconel & Risner 1990).

Above results make a conclusion that cash flow statement as the first order of importance that SMEs perceive as important in their decision making. These results coincided with that, SMEs monitor their cash position closely in order to maintain better relationship with banks as their lenders (Chittenden, Mcconel & Risner 1990).

In order to understand the different purposes behind that the SMEs tend to prepare the financial statements, study observes mainly about the following underlined purposes. SMEs prepare the financial statements to fulfill statutory requirements, financing requirements (i.e whether they prepare financial statements with the intention of providing bank and other financial institutions to raise the external finance) and day today operative requirements.

Table 7: Purposes of preparing financial statements

Purposes		Frequency	Percentage
Fulfill statutory requirements	Yes	01	2%
	No	59	98%
Financing purposes	Yes	40	67%
	No	20	33%
Day today operative purposes	Yes	53	88%
	No	07	12%

Source: Author Compiled

As stated in the introductory chapter, though The Institute of Chartered Accountants of Sri Lanka introduced the requirement of adopting separate standard for SMEs and adopted the IFRS for SMEs with effect from 1st January 2012, the results of the study revealed that, fulfilling of such a requirement is at questionable stage. Since findings of the study showed that almost all the SMEs are not preparing the financial statements with the purpose of fulfilling that as a statutory obligation. The highest percentage representing 88% denotes that SMEs are preparing financial statements as a supportive for day to day operations. Around 67% of SMEs prepare the financial statements with the intention to fulfill the financing purposes.

The literature suggested that after complying with statutory requirements there is no other use of financial statements given by most SME owner/managers. According to the results of the study conducted by DeThomas & Fredenberger in 1985, most of small businesses prepare financial reports for statutory purpose, but many fail to use these reports. SMEs owners/managers either lack the technique for using financial statements or simply are unaware that they can use them to support the financial decisions (DeThomas & Fredenberger, 1985).

The results of the study demonstrated that majority of Sri Lankan SMEs prepare the financial statements with the intention to meet the day today operative requirements. Thus most of the SMEs may not follow the proper formats of preparation of financial statements since they do not have any intention to meet the statutory obligations. But poorly prepared accounting information render most SMEs unable to evaluate their own financial situation, or to demonstrate viability of the business, and or to facilitate loan financing. This situation is having possible implications for Sri Lankan SMEs, to make improper financial decisions and ended up with low performance and high failure rate.

The SMEs main concern behind the preparation of financial statements is to conduct their day to day operations of the businesses by getting the inputs from the financial statements which is the highest percentage amounting to 88%.

4.1 CONCLUSION

The findings demonstrated that all SMEs were legally organized in the form of sole proprietorships and private limited companies. Mainly SMEs pay more consideration in preparation and monitoring of three components of financial statements balance sheet, statement of profit and loss account and cash flow statement. It is evident that Sri Lankan SMEs prepare the reports which help the owner/managers to control financial position and performance of the business. Results demonstrated that the highest importance was placed on preparation and monitoring of cash flows of the businesses which is crucial to the success and survival of SMEs. But significant proportion of SMEs kept inadequate financial reports and maintained the informal accounting systems and do not prepare comprehensive set of financial reports. It is paramount important that providing up to date, comprehensive set of financial reports for the decision making within this dynamic and complex business environment prevailing in Sri Lanka. As such, availability of financial expertise in the business as a separate manager is important to manage the firm's financial affairs so as to maximize the value of the firm. Findings revealed that less number of SMEs has the segregation of owners from the managers of their businesses.

Private Limited SMEs have more tendencies towards the application of computers in the accounting information system comparing to the SMEs operating as sole proprietorships. The most frequent applications of computers are recording day today business transactions, preparation of accounting reports and cash flow management activities. Although SMEs usually use computers for the above transactions, the ability to apply accounting software is limited. This is an outcome of limitations of financial and human resources within SMEs, which means SMEs have difficulty in developing and carrying out projects providing accounting information system computerization. Therefore, the study realized that SMEs in Sri Lanka have less interest towards the financial reporting practices and limited usage of commercially available standard accounting software. The paper concludes that, concerted effort should be made to motivate SMEs towards the usage of computerized accounting packages and to conduct extensive training programmes of such packages. Thus it is essential to establish a vibrant network of BDS providers to facilitate the SME sector as recommended in White paper 2002. When SME entrepreneur needs professional advice on a specific problem relating to the operation of his enterprise, he/she should be able to access quality and reliable professional advice to resolve the problem.

The results of the study demonstrated that, majority of Sri Lankan SMEs prepared the financial statements with the intention to meet day today operative requirements and it was not with the purpose of fulfilling that as a statutory requirement. Fulfillment of financing purposes is also another importance of preparation of financial statements by SMEs. Though the Institute of Chartered Accountants of Sri Lanka introduced the requirement of adopting separate standard for SMEs and introducing IFRS for SMEs with effect from 1st January 2012, there is an importance of implementation of proper monitoring mechanism by governing bodies to ensure the extent of fulfillment of such statutory obligation by SMEs.

5.1 REFERENCES

- Abeygunasekera, A.W. J. C. & Fonseka, A. T. (2012). *Non-compliance with standard accounting practices by small and medium scale enterprises in Sri Lanka*. Postgraduate Institute of Management, University of Sri Jayawardenepura, Sri Lanka.
- Annual report (2011). *Central Bank of Sri Lanka*, Sri Lanka.
- E&Y (2012). *Beyond hurdles of financial reporting: SLFRS for SMEs*, Ernst & Young.
- Gamage, A. (2000). *Effectiveness of entrepreneur development programme in the creation and growth of SMEs in Sri Lanka*, University of Sri Jayawardenepura, M.Sc. Research paper, University of Sri Jayawardenepura, Colombo, Sri Lanka.
- Hashim, M. & Wafa, S. (2002). *Small and medium sized enterprises in Malaysia: Development issues*, Prentice Hall, Malaysia, Kuala Lumpur.
- Huck J. F., & McEwen, T. (1991). Competencies Needed for Small Business Success: Perceptions of Jamaican Entrepreneurs, *Journal of Small Business Management*, 04, 90-93.
- MED (2002). National strategy for small and medium enterprises sector development in Sri Lanka, *White paper*, Ministry of Enterprise Development, small and medium enterprise sector development programme.
- NEDA (2011). *SME Guide Book – A guide towards a better business*, Ministry of Industry and Commerce, National Enterprise Development Authority, Sri Lanka.
- Pandey, I. (2004). *Financial Management*, 8th edn, Vikas publishing house Pvt Ltd, Delhi.
- PWC (2012). Sri Lanka budget proposal, *Price Waterhouse Coopers*.
- Sarapaivanich, N. (2003). *The use of financial information in financial decisions of SMEs in Thailand*, 16th Annual conference of small enterprise association of Australia and New Zealand, Ballarat.
- Secretariat (2012). *The National Human Resources and Employment Policy for Sri Lanka*, Secretariat for Senior Ministers, with technical and financial support by the International Labour Organisation.
- Stice, J., Stice, E., Albrecht, W., Skousen, R., & Swain, M. (1999). Accounting information users and use, *South Western, Accounting and Business Research*, 55, 221-224.