



Accounting Practices among Micro, Small and Medium-Sized Enterprises (MSMEs) in Bandung, Indonesia

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Abstract

Micro, small and medium-sized enterprises (MSMEs) are a key source of employment and economic growth especially in developing countries. MSMEs in Indonesia are growing fast. They have made significant contributions in generating more than 99.99% of the total number of enterprises, 97.24% of employment, 57.94% of Gross Domestic Product (GDP) and 16.44% of total national non-oil and gas export in 2011. MSMEs become the main contributors to economic development in Indonesia over the years. Eventhough MSMEs play a vital role in economic development, majority of them do not keep complete accounting records to prepare financial statements with some not preparing any financial statements at all because of lack of accounting skill and knowledge and weak of law enforcement. This research aims to examine the purpose of preparing accounting information, the importance of financial accounting information for decision making, the types of accounting records being kept and maintained by MSMEs, the availability of accounting skill and knowledge to provide accounting information and the main obstacle faced by MSMEs in order to provide proper accounting information. The survey research design was used and postal questionnaires were distributed to selected MSMEs in order to collect primary data. With relevant collected data, analysis was then conducted and conclusions drawn.

Keywords: *Micro, small and medium-sized enterprises (MSMEs), accounting records, accounting information.*

INTRODUCTION

It has been recognized that small and medium-sized enterprises (SMEs) play an important role in the economic growth and sustainable development, not only in developing but also in developed countries. In developing countries, SMEs have a crucial role to play because of their potential contributions to improvement of income distribution, employment creation, poverty reduction, export growth and development of entrepreneurship, industry and rural economy (Tambunan & Xiangfeng, 2006; Moore et al., 2008). The role of SMEs in promoting grassroots economic growth and equitable sustainable development is significant. There is a positive relationship between the relative size of the SMEs sector and economic growth. In average, formal SMEs contribute to almost 50% of Gross Domestic Product



(GDP) of high-income countries (Beck, et al., 2005; Ayyagari et al., 2007; Kachembere, 2011).

MSMEs have historically been the main player in the Indonesian economy, especially as a large provider of employment opportunities, and hence a generator of primary or secondary sources of income for many households (Tambunan, 2006). MSMEs have been the main contributors to employment growth in Indonesia in recent years in comparison to other average lower-middle income countries. This helped to sustain household income during the crisis and is one of the factors contributing to the steady decline in the poverty rate (Mourougane, 2012). Moreover, according to the 2011 data of the Ministry of SMEs and Co-operatives, with the population of approximately 241 million people in year 2012, employment is one of the crucial factors to the improvement economic sector in Indonesia.

MSMEs represented 99.99% of the total number of enterprises in Indonesia (55,206,444 MSMEs of the total 55,211,396 enterprises); 97.24% of employment (101,722,458 of the total 104,613,681 workforce); 57.94% of gross domestic product (GDP) at market value (IDR 4,303,571.5 billion of the total IDR 7,427,086.1 billion or approximately US\$ 430.36 billion of the total US\$ 742.71 billion; 16.44% of total non-oil and gas export (IDR 187,441.82 billion of the total IDR 1,140,451.10 billion or approximately US\$ 18,744 million of the total US\$ 114,045 million at exchange rate US\$ 1 = IDR 10,000). Obviously, MSMEs play a significant role in economy of Indonesia.

Based on the Bank Indonesia Survey 2005, access to finance is the main obstacle to investment for small firms in Indonesia. Limited access to finance is a significant barrier to the growth of SMEs and to the high rate of failure among SMEs (Beck&Demirguc-Kunt, 2006; Tung&Aycan, 2008). In order to survive, SMEs owners and managers need updated, accurate and timely accounting information. Accounting information is used to measure and communicate financial information of firm that is needed by management in decision making. Accounting information has an important influence to the business success of SMEs, therefore it is important that accounting practice of SMEs could provide complete and relevant financial information needed by entrepreneurs in decision making. However, majority of SMEs do not maintain sufficient accounting records that are necessary in their decision making. SMEs lack of access to capital and burden of high rate charges are partially the result of incomplete (or no) accounting records, and the inefficient use of accounting information. Poor record keeping and accounting information make it difficult for financial institutions to evaluate potential risks and returns (World Bank, 1978; Nayak&Greenfield, 1994).

LITERATURE REVIEW

Characteristics of Small and Medium-Sized Enterprises



There is no commonly-agreed definition and classification of small and medium enterprises across institutions and countries. Below are the definitions from the several sources that are used in this research:

- Ministry of SMEs and Co-operatives.

According to the 2008 Law regarding micro, small and medium-sized enterprises, micro firms are defined as enterprises with net assets less than IDR 50 million or approximately US\$ 5,000 (land and buildings excluded) or enterprises which have less than IDR 300 million for the total annual sales or approximately US\$ 30,000. Small firms are enterprises with net assets from IDR 50 million to IDR 500 million or approximately US\$ 5,000 to US\$ 50,000 (land and buildings excluded) or with total annual sales of IDR 300 millions to IDR 2.5 billion, or approximately US\$ 25,000 to US\$ 250,000. Medium-sized firms are those with net assets of IDR 500 million to IDR 10 billion or approximately US\$ 50,000 to US\$ 1,000,000 (land and buildings excluded) or with total annual sales of IDR 2.5 billion to IDR 50 billion or approximately US\$ 250,000 to US\$ 5,000,000 (at exchange rate US\$ 1=IDR 10,000)

- World Bank Enterprise Survey.

A small size firm is defined as a firm with 5-19 employees, and a medium-sized firm is with 20-99 employees. The survey covered only the formal sector and firms with more than 5 employees.

- International Finance Corporation-MSME country information.

The definition varies across countries. For Indonesia, data is for the formal sector and was taken from the Ministry of SMEs and Co-operatives. Hence, the definitions adopted by the International Finance Corporation are the same as those in the 2008 Law, as explained above.

- The National Agency for Statistics (BPS)-Indonesia

BPS which regularly conducted surveys of MSMEs, uses the number of workers as the basis to determine the size of an enterprise. In its definition, micro-sized enterprise is a unit with 1-4 workers, small-sized enterprise is with 5-19 workers, medium-sized enterprise is with 20-99 workers, and large-sized enterprise is with 100 or more workers. Hence, the definitions are the same as those adopted by the World Bank Enterprise Surveys.

Accounting Practices among SMEs

It has been recognized that appropriate accounting information is important for a successful management of a business whether it is large or small. The importance of internal and external accounting as a source of information for owners and managers of small enterprises and their different stakeholders is steadily growing.



It is important that the accounting systems applied by small enterprises, meet their actual needs by providing necessary information yet avoiding unjustified administrative burden (European Commission, 2011). Accounting may be best defined as identification, measurement and communication of financial information about economic entities to interested persons (Kieso et al., 2011). Accounting systems provide a source of information to owners and managers of SMEs. In other words, the lack of proper accounting records has contributed to the failure of many SMEs. The most important factors to the success of the business are: 1) finance and accounting; 2) management; and, 3) marketing. Hence, accounting plays a significant role in the success of business institutions. Accounting systems are responsible for, among others, recording, analyzing, monitoring, and evaluating the financial condition of companies, preparation of documents necessary for tax purposes, providing information support to many other organizational functions (Hess, 1987; Amidu et al., 2011).

Simpson, et al. (2004) have investigated the impact of education, training, development, prior-knowledge and experience to the success of small businesses. While most businesses relied heavily on prior knowledge and experience, the study finding reveals that education and training had a positive effect on the success of the business. Previous study of Wichmann (1983) reveals that accounting and marketing pose major challenges to management of SMEs. Hence, it is important that managers or owners of SMEs learn accounting or hire experts. The development of a sound accounting information system in SMEs depends on the owner's level of accounting knowledge (Ismail and King, 2007). Sophisticated financial reporting system is necessary in order to ensure that SME's resources are used effectively and efficiently. The information must be accurate and reliable in order to provide a platform for timely and sound decisions (Mahon, 1999). The main problem is that most of business owner and managers of micro enterprises not keeping sufficient records to aid them in their decision-making. Therefore, it becomes difficult for them to prepare proper financial statements because of poor or insufficient records. Inadequate accounting information system resulted in unavailability of adequate accounting information, which in turn can harm and lead to failure of its small firms. Majority of micro businesses rely more heavily on manual methods, while small businesses are more likely to use computerized systems. In terms of accounting reports, the profit and loss statement is produced by 65% of micro business and 80% of small businesses, yet significantly more small businesses produce a balance sheet. The use of accounting software by owner-managers in SMEs will improve accounting practices (Dyt&Halabi, 2007; Zhou, 2010).

According to the results of previous studies, some factors that affect the success or failure of SMEs are managerial expertise and leadership (Peterson et al.,



1983); management capabilities (Wichmann, 1983; Huang&Brown, 1999); managerial inadequacy incompetence and inexperience (Haswell&Holmes, 1989). Based on the World Bank Enterprise Survey, several principal obstacles of investment to SMEs in Indonesia are: 1) access to finance; 2) access to land; 3) business licensing and permits; 4) corruption; 5) courts; 6) crime, theft and disorder; 7) customs and trade regulations; 8) electricity; 9) workforce education; 10) labor regulations; 11) political instability; 12) practices of the informal sector; and 13) tax administration. Access to finance is by far the greatest impediment to investment for SMEs. While the lack of financial instruments prevents excess liquidity from being channeled into financing tangible investment, small firms face additional difficulties. Many small businesses cannot get credit because they are unable to provide the types of collateral required and hence face harsher bank lending terms in comparison to larger firms (Mourougane, 2012)

Previous research findings indicate that accounting practices among MSMEs in Indonesia have not been going well (Srikandi&Setyawan, 2010; Kurniawati&Hermawan, 2012; Rudiantoro&Siregar, 2012). Weaknesses in accounting practice due to several factors such as educational factors and accounting standards overload which are used as guidelines in the preparation of financial statements (Nair&Rittenberg, 1983; William et al., 1989; Ball&Shank, 1995; Simpson&Bellamy, 2004; Suhairi&Wahdini, 2006).

RESEARCH METHODOLOGY

As a country with a huge population of approximately 241 million people, consists of thousands of islands and divided into 33 provinces, Indonesia has increased economic growth from year to year. The structure of the Indonesian economy in 2011 was dominated by a group of provinces on Java island, which gave the largest contribution of 57.5% to the total gross domestic product (GDP) of Indonesia which amounted to IDR 7,427.10 trillion (approximately US\$ 742.71 billion at exchange rate US\$ 1 = IDR 10,000). The next highest contributors are provinces in Sumatra island (23.6%), Borneo island (9.7%), Sulawesi island (4.6%), Bali and Nusa Tenggara island (2.6%) and Maluku and Papua island (2%). Based on the comparison of the provinces across Indonesia, the three largest contributing provinces, all of which are located in Java island, are Jakarta (16.5%), East Java (14.7%), and West Java (14.3%) (BPS Survey, 2011)

West Java Province as the third largest contributor to the GDP of Indonesia, consists of 26 counties/cities and has achieved economic growth of 4-9% in 2011. There are three main sector which are the major contributors to GRDP of West Java Province in 2011, namely: 1) manufacturing industries (37.16%); 2) trade, hotel and restaurant (22.58%), and 3) agriculture sector (11.98%). Gross Regional Domestic



Bruto (GRDP) is one indicator among several economic indicators used as a substance in decision making process.

In West Java Province, the highest economic growth was achieved by Bandung city (8.73%). GRDP of Bandung city reflects a significant growth, at current market price from IDR 82,022,176 million in 2010 raise to IDR 95,612,863 million in 2011 (or approximately from US\$ 8,202.22 million to US\$ 9,561.29 million), which means a nominal increased GRDP of 16,60%. At constant market price (2000), GRDP increased from IDR 31,697,282 million in 2010 to IDR 34,463,631 million in 2011 (or approximately from US\$ 3,169.73 million to US\$ 3,446.36 million, at the exchange rate US\$ 1 = IDR 10,000). Hence, there was a nominal increased GRDP of 8.73%.

From this point of view, registered MSMEs in Bandung city are determined as a target population in this research, because those firms are monitored regularly by the government. Therefore, it is assumed that MSMEs have received adequate information regarding the importance of accounting information system in providing financial statements as required by the Government's accounting standards for SMEs (SAK-ETAP). According to BPS survey, the contribution of MSMEs to GRDP of Bandung city in 2011 is 58.62% (see table below).

Table 1. Gross Regional Domestic Product of Bandung in 2011

Size	GRDP (in billions)	± GRDP (in millions)	%
MSMEs	IDR 56,050.80	US\$ 5,605.08	58.62
• Micro	IDR 17,443.70	US\$ 1,744.37	18.24
• Small	IDR 12,839.48	US\$ 1,283.95	13.43
• Medium	IDR 25,767.63	US\$ 2,576.76	26.95
Large enterprises	IDR 39,562.06	US\$ 3,956.21	41.38
Total GRDP at current market price	IDR 95,612.86	US\$ 9,561.29	100.00

Source: BPS Survey

A survey research design was used in this study. Postal questionnaires were then distributed in order to collect primary data. Target population of this study is comprised of 4,425 registered MSMEs from the total of 333,512 MSMEs, both registered and unregistered, in Bandung city as per 2011 (Source: The Ministry of SMEs and Co-operatives). After the population was determined, minimal sample size was randomly selected using Taro Yamane formula (1967). Total 98 SMEs were considered as a minimum sample (see calculation below).



$$n = \frac{N}{Nd^2 + 1}$$

Where: n = sample size
N = population size
d = the level of precision (10%)

$$n = \frac{4,425}{4,425(0,1)^2 + 1}$$
$$n = 97.79$$

The aim of this research is to examine the purpose of preparing accounting information, the importance of accounting information for decision making, the types of accounting records being kept and maintained by MSMEs, the availability of accounting skills and knowledge to provide accounting information, and the main obstacle faced by MSMEs in order to provide proper accounting information.

SURVEY RESULTS

With total 100 questionnaires were distributed to selected MSMEs, so far there are 42 questionnaires forms were adequately completed by the respondents represents 42% response rate (per August 2013). While the data is still on-going, descriptive analysis was performed and preliminary conclusion was drawn based on the completed questionnaires so far for the purpose of this paper. The writer anticipates some potential amendments to the descriptive analysis and preliminary conclusions in future as the questionnaires are expected to be completed by the selected MSMEs.

In terms of characteristics of firms (appendix 1) the survey findings reveal that based on assets and annual sales, a great numbers of firms in Bandung city are small business (50%), micro business (26%) and medium business (24%). Based on number of employee's category, firm can be categorized as small enterprises (40%), medium enterprises (40%) and micro enterprises (20%). Majority of those firms are a sole-proprietor (45%), corporation (33%) and partnership (22%). In terms of business sector, trade is the biggest contributor (62%), followed by service (17%), food and beverage (12%), manufacturing (7%) and fashion (2%). Based on the length of services, those firms have been operating from 3-5 years (38%), 6-10 years (33%), less than 3 years (15%), 11-20 years (12%) and 21-50 years (2%). Hence, we can see that most of the firms in Bandung city are SMEs, majority of which are running in trading sector and with experience of less than 10 years.

In terms of the educational background of the owner of the firms (appendix 2) the survey findings indicate that most of the owners have formal education in non



accounting degree (50%), secondary (26%), non accounting diploma (17%), post graduate degree in accounting (5%) and primary school (1%). Majority of them at middle age between 31-40 years (45%), followed by those between 41-50 years (38%), above 50 years (14%) and between 21-30 years (3%). Hence, we can see that most of the business owners are young entrepreneurs with no educational background in accounting. Their knowledge in accounting is at various levels depending on learning experiences as they run the businesses.

In terms of purpose of preparing financial information (appendix 3), the results show that most of the firms prepared financial information for assessing profits (52%), measuring business growth and performance (17%), tax preparation (17%), capital budgeting (17%) and planning for future operations (2%). Based on the question on the importance the financial accounting information for MSMEs (appendix 4), it can be described that most of them assumed that financial accounting information is important (48%), while others assumed very important (43%) and somewhat important (9%). Hence, we can see while most of respondents found accounting information for their businesses many of them prepared financial information for limited purposes, most of which are for assessing profits.

In terms of the type of accounting records being kept and maintained by MSMEs (appendix 5), the results show that majority of the firms (95%) did not provide financial statement regularly. In other words only 5% of MSMEs provide financial statement regularly. However they are regularly recording business transaction and completely keeping the documents needed. Type of accounting records being kept and maintained by MSMEs are sales (receipt) book (36%); purchases (order) book (29%); expenditure book (19%); asset register (14%) and payroll records (2%). Account or ledger being kept and maintained are: cash (31%), accounts receivable (29%), inventory (29%), accounts payable (5%), fixed assets (5%) and payroll (3%). Most of respondents choose cash basis (64%) as a method of recording the transaction while the others choose accrual basis (36%). Majority of respondents (79%) use computer in recording transaction and some of them (70%) use accounting software in operation.

In terms of the availability of accounting skill and knowledge (appendix 6), the results indicate that most of the owners do not have adequate accounting skills and knowledge (71%), therefore accounting and financial statements in MSMEs were mainly prepared by external consultant (69%) and internal accounting staff (29%). Only 2% of them were prepared by the the owners themselves.

Finally, in terms of obstacles and challenges faced by MSMEs (appendix 7), the results show that the reasons of MSMEs not preparing financial statements are due to not having adequate accounting knowledge (55%), lack of skill in recording or financial reporting (43%) and high cost (2%). Respondents are of the opinions that those



accounting problems could be solved by: 1) hiring external consultant (76%); 2) attending bookkeeping/accounting training (17%); and 3) learning about accounting standards for SMEs (SAK-ETAP) (7%).

CONCLUSIONS, LIMITATIONS AND RECOMMENDATIONS

Conclusions

From the limited data and results gathered so far, the following preliminary conclusions are drawn: majority of MSMEs in Bandung are a sole-proprietor which has been in operation for less than 10 years and mainly doing business in trade sector. Most of the owners' backgrounds are non accounting degree and young with the age of 31-40 years old. The objective of the firms preparing financial information is mainly to assess profitability of firm. Most of respondents agreed that financial accounting information is important in decision making. However, the results also indicate that most of MSMEs do not provide financial statements periodically, but regularly record business transaction and completely keep the documents needed. Types of accounting records being kept and maintained by them are sales (receipt) book, purchases (order) book, expenditure book, asset register and payroll records. Types of account or ledger being kept and maintained are cash, accounts receivable, inventory, accounts payable, fixed assets, and payroll. Most of MSMEs choose cash basis method rather than accrual basis method that is required by the accounting standards for MSMEs (SAK-ETAP).

Majority of owners do not have adequate accounting skill and knowledge, therefore accounts and financial statements among MSMEs are mainly prepared by external consultant and internal accounting staff rather than being prepared by owner himself. The obstacle of MSMEs not preparing financial statement but choose recording transaction regularly and keeping all records and documents needed is because most of them do not have adequate accounting knowledge and lack of skills in financial reporting. In order to resolve these problems, most of them choose to hire external consultant, planning to attend the training of bookkeeping/accounting and to learn about accounting standards for MSMEs (SAK-ETAP). The results also show that MSMEs rely more heavily on computerized system rather than manual systems.

Limitations and Recommendations

This research has limitations in sample size (42% respondents rate so far), hence its findings could only result in preliminary conclusions so far. As variability of MSMEs is limited to Bandung city, and also has not been tested statistically, the results may not necessarily reflect the situations of MSMEs in other provinces in Indonesia. Hence it is recommended for further research could be conducted in future to further examine the reasons why MSMEs do not provide financial statements as



required by accounting standards. In the future, the ministry of SMEs and Co-operatives of Indonesia need to focus on improving the knowledge of the owners and managers of MSMEs on accounting and also strengthening the law enforcement particularly on the obligation for MSMEs to provide financial statements in compliance with the accounting standards (SAK-ETAP). From this limited data, it can be concluded at this point of time that the main obstacles faced by MSMEs that do not provide financial statements are the lack of accounting knowledge and weak of law enforcement by the government. Only when MSMEs apply accounting standards (SAK-ETAP) and provide financial statements, it would be easier for the banks to assess the feasibility of the MSMEs' businesses. Hence MSMEs will have a greater opportunity to earn credit scheme. In addition, it will help them to increase performance.

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Appendices

Appendix 1. Characteristics of Firms

	Frequency	Percentage (%)
<i>Size (based on assets and annual sales)</i>		
• Micro	11	26
• Small	21	50
• Medium	10	24
<i>Form</i>		
• Sole-proprietor	19	45
• Partnership	9	22
• Corporation	14	33
• Others	-	-
<i>Sector</i>		
• Fashion	1	2
• Food and Beverage	5	12
• Handicraft	0	0
• Service	7	17
• Manufacturing	3	7
• Trade	26	62
<i>Number of Employees</i>		
• ≤ 4 persons (Micro)	8	20
• 5-19 persons (Small)	17	40
• 20-99 persons (Medium)	17	40
<i>Business Age</i>		
• ≤ 2 years	6	15
• 3-5 years	16	38
• 6-10 years	14	33
• 11-20 years	5	12
• 21-50 years	1	2
• > 50 years	-	-



Appendix 2. Background of Owner

	Frequency	Percentage
Formal Education		
Primary	1	2
Secondary	11	26
Diploma		
• accounting	-	-
• non accounting	7	17
Degree		
• accounting	-	-
• non accounting	21	50
Postgraduate Degree		
• accounting	2	5
• non accounting	-	-
Owner Age		
• < 20 years	-	-
• 21-30 years	1	3
• 31-40 years	19	45
• 41-50 years	16	38
• > 50 years	6	14

Appendix 3. Purpose of Preparing Financial Information

	Frequency	Percentage
Purpose of preparing financial information		
• Tax preparation	7	17
• Assessing profitability of firm	22	52
• Measuring business growth and performance	7	17
• Planning for future operations	1	2
• Capital budgeting	5	12

Appendix 4. The Importance of Financial Accounting Information

	Frequency	Percentage
Importance of financial accounting information in decision making		
• Not important	-	-
• Less important	-	-
• Somewhat important	4	9
• Important	20	48
• Very important	18	43



Appendix 5. Accounting Records and Financial Information

	Frequency	Percentage
<i>Providing financial statement periodically</i>		
• Yes	2	5
• No	40	95
<i>Regularly recording transaction and completely keeping the document needed. (no financial statement provided)</i>		
• Yes	40	95
• No	2	5
<i>Accounting records being kept and maintained by SMEs</i>		
• Purchases (Order) Book	12	29
• Sales (Receipt) Book	15	36
• Expenditure Book	8	19
• Payroll Records	1	2
• Asset Register	6	14
• No Records	-	-
<i>Account/ledger being kept and maintained by SMEs</i>		
• Accounts Receivable	12	29
• Accounts Payable	2	5
• Cash	13	31
• Fixed Assets	2	5
• Inventory	12	29
• Payroll	1	3
• Others	-	-
<i>Accounting bases adopted</i>		
• Cash Basis	27	64
• Accrual Basis	15	36
<i>Using computers in operation</i>		
• Yes	33	79
• No	9	21
<i>Using accounting software in operation</i>		
• Yes	23	70
• No	10	30



Appendix 6. Availability of Accounting Skill and Knowledge

	Frequency	Percentage
<i>Owner have accounting skill knowledge</i>		
• Yes	12	29
• No	30	71
<i>Preparers of accounts and financial statements in SMEs</i>		
• Internal Accounting Staff	12	29
• External Consultant	29	69
• Owner-Manager	1	2

Appendix 7. Obstacles and Challenges

	Frequency	Percentage
<i>Obstacles in preparing financial statement</i>		
• Not having accounting knowledge	23	55
• Lack of skill in recording or financial reporting	18	43
• Highly Cost	1	2
• Inadequate of accounting standards	-	-
• Others	-	-
<i>Ways of improving competence on accounting practice</i>		
• Training of bookkeeping (accounting)	7	17
• Learning in accounting standards for SMEs (SAK-ETAP)	3	7
• Hiring external consultant	32	76
• Others	-	-