

**ACCOUNTING AND FINANCIAL STATEMENTS FOR  
SMALL MEDIUM ENTERPRISES IN INDONESIA  
THEORITICAL AND PRACTICES PERSPECTIVES**

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**Abstract**

This paper will discuss about accounting and financial statements for Small Medium Enterprises (SMEs) in Indonesia from two perspectives include theoretical and practices in. The SMEs will support economic growth and assist in reducing poverty through job creation and promotion of labor-intensive. The small medium enterprises have two kinds of problem such as financial and non financial. Financial problem is related to lack of capability in SMEs to have capital to expand their business. Furthermore, non financial problem is related to the lack of management performance. In conclusion, not all financial statements may be prepared, financial statements may not be prepared with sufficient detail, Financial statements may not be prepared appropriately based on Accounting Standard, Financial statements may be prepared irregularly and/or infrequently, Financial statements may not be provided to all parties, financial statements should be routinely analyzed and interpreted by SMEs.

*Keywords: Accounting, Financial Statements, Small Medium Enterprises.*

**Introduction**

The number of Small Medium Enterprises (SMEs) in Indonesia is increasing rapidly nowadays. Small Medium Enterprises in Indonesia remain optimistic about the prospects for their economic growth and trade activity. Not only government but also community and banking concern about their growth. For example government gives some financial fund in the SMEs to make easier for them to grow, because the SMEs will support economic growth and assist in reducing poverty through job creation and promotion of labor-intensive. Based on Hill, 2001 suggested that firstly, SMEs in any country play a pivotal role in economic development. They

typically employ 60% or more of country's industrial workforce and generate up to half of the sector's output. SMEs are therefore an important component to any understanding of the broader industrialization process. Secondly, SMEs are a clear and consistently enunciated Indonesian government priority.

Based on Central Bureau of Statistics (BPS) data in 2008 the number of micro, small and medium enterprises (SMEs) develop into 51.26 million and able to contribute to the total national Gross Domestic Products (GDP) amounted to 52.7%, or about Rp2.609, 4 trillion of total GDP Rp4.954, 0 trillion. SME sector is also able to absorb labor force 90.9 million people or 94.4% of the total national workforce. It can be seen from table 1 in the following:

**Table 1**  
**The Growth of SMEs in Indonesia -2008**

No	Business Type	Total (unit)		Increase	
		2007	2008	Total	%
1	Small	49.820.000	51.260.000	1.440	0,002%
2	Medium	498.000	520.000	22.000	4,23%
	SMEs	50.318.000	51.780.000	1.462	0,0282%
3	Corporation	38.000	40.000	2.000	5%
	<b>Total</b>	50.356.000	51.820.000	1.464	0,02%

Source: BPS 2008

The contributions of SMEs in promoting the growth of Indonesia economy are very important. It would provide job opportunities, enhance the quality of human resources, nurture a culture of entrepreneurship, foster creativity, and open up new business opportunities. Beside that, SMEs will play an increasingly important role in the new economy.

In developing Asia, SMEs have made significant contributions over the years measured in terms of their share in: (a) number of enterprises; (b) employment; (c) production and value added; (d) GDP; (e) enterprises set

up by women entrepreneurs; and (f) regional dispersal of industry, among others. The contribution of SMEs is vital in as much as they, by and large: (a) make up 80-90% of all enterprises; (b) provide over 60% of the private sector jobs; (c) generate 50%-80% of total employment; (d) contribute about 50% of sales or value added (VA); (e) share about 30% of direct total exports (Narain, 2003).

However, there are a number of constraints common to all SMEs. The constraints may differ from region to region, between rural and urban, between sectors, or between individual enterprises within a sector. The most common problems for SMEs are lack of access to market information, technology, and low quality of human resources and lack of access to capital and difficulty to prepare financial statement in accounting and also lack of access to relevant business information,. For instance, banks usually regard lending to SMEs is a high risk and unprofitable business due to: unavailability of accurate, reliable information on enterprises' financial condition and performance. It is related to how they can make financial statements in accounting. This paper will discuss about the accounting and financial reporting in SMEs in Indonesia.

### **The Definition of Small Business**

In Indonesia, there are several definitions of SMEs, depending on which agency provides the definition as follows:

**Table 2. Definition of SMEs**

<b>Institution/Law</b>	<b>Size of business</b>	<b>Criteria</b>
Law No.9/1995 about Small Business	Small Business	<ul style="list-style-type: none"> <li>• Asset <math>\leq</math> IDR 200 million excl land &amp; building</li> <li>• Annual sales up to IDR 1 billion</li> <li>• Owned by Indonesian citizen not affiliated with middle or corporate.</li> <li>• With or without having legal entity</li> </ul>
Central Bureau of Statistics (BPS)	Micro Business	Employee up to 5 people including family workers
	Small Business	Employee up to 19 people
	Middle Business	Employee up to 19 people

Law No. 10/1999	Medium Business	Asset IDR 200 million – IDR 10 billion
Bank Indonesia (central Bank)	Micro Business	<ul style="list-style-type: none"> <li>- Very small scale business that run by family members</li> <li>- Local resources and simple technology</li> <li>- Easy to exit and entry</li> </ul>
	Small business	<ul style="list-style-type: none"> <li>- Asset <math>\leq</math> IDR 200 million excl land &amp; building</li> <li>- Annual sales <math>\leq</math> IDR 1 billion</li> </ul>
	Medium Business	<ul style="list-style-type: none"> <li>- Asset <math>\leq</math> IDR 5 billion for industrial sector</li> <li>- Asset <math>\leq</math> IDR 600 million for non industrial sector</li> <li>- Annual sales <math>\leq</math> IDR 3billion</li> </ul>

The World Bank has more concise classification of SMEs based on number of employees, total assets and annual sales. Micro enterprises are define as individual/firms with total assets less than \$ 100,000, total sales less than 2 \$100,000 and employ less than 10 persons. Small enterprises are individuals/firms with total assets or annual sales between US \$100,000 up to US \$ 3 million and employ 10–50 persons. Medium enterprises are individuals/firms with total assets or annual sales more than US \$3 million up to US \$ 15 million and employ more than 50 up to 300 persons.

Osteryoung and Newman (1993) suggested that a business be defined as small if its shares are privately held and are not available to the public at large, and if the owners must personally guarantee all financing of the business. Moreover, Osteryoung *et al* (1995) examined the US Small Business Administration (SBA) definitions for the manufacturing and wholesaling sectors. The SBA defines a manufacturing business as small if it has 500 or fewer employees and a wholesaling business as small if it has 100 or fewer employees. They concluded that both of these break points were too high. Naturally occurring break points based on differences in financial characteristics, operations and performance appeared to be well below those used by the SBA. However, the overall explanatory power of the relationships tested was low.

Cheah (1990, p. 343) describes as 'profitable discrepancies, gaps, and mismatches in knowledge and information that others have not yet exploited'. In this scenario, the financial information provided by a conventional accounting system is likely to have less importance to decision-making by owner-managers of SMEs. According to Kellen (2004), small medium enterprises have several characteristics include simple accounting, a little business margin, lack of capital and management. SMEs usually are home industries.

In conclusion, the Small Medium enterprises is usually established and owned by one person. The SMEs is quite small if we look from the capital and the size of the company and also the employee.

### **Accounting and Financial Statement for SMEs Theoretical Perspectives**

Friedlob & Plewa (1984, 1992) mentions that SMEs employ the way of financial reporting system as follows:

- Most of SMEs use strictly cash based accounting with no accruals. Because Cash based accounting is easier for them to make financial statements.
- Income tax basis accounting (in compliance with income tax legislation) which includes accruals for inventories, receivables and depreciation. The SMEs sometimes have difficulty to account the tax from their business.
- Prepare their financial statements by using basic full accrual accounting with no compliance to accounting standards. The SMEs occasionally do this.
- The SMEs prepare their financial statements by using basic full accrual accounting with footnote disclosures of departures from accounting standards.

- Some of the SMEs use full accrual accounting for private companies in which certain accounting standards are considered irrelevant, and therefore are not required to be complied with (for example, an accounting standard dealing with consolidated financial statements).
- SMEs use full accrual accounting as for public companies with compliance to all accounting standards unless it can be demonstrated that adherence to a certain accounting standard would result in misleading financial reports being produced.

The important issue is the extent to which external auditors are permitted or are able to attest to the veracity of the financial reports produced using these various financial reporting systems.

Non-participants are likely to have fewer resources available to deal with financial reporting compliance than larger company, capital market participants, thus concerns regarding the relatively heavy financial reporting burden on non-participants are justified. Some evidence supporting this contention appears in the literature. For instance Hartcher (2004) reported the results of a national survey of the Australian small business sector that showed the sector has difficulty in keeping abreast of compliance changes and understanding financial reporting obligations. Hartcher recommended that compliance costs be measured by all levels of government and reviewed on a regular basis. Earlier Carsberg *et al.* (1985) and Abdel-khalik (1983) concluded that small USA firms appeared to have a substantial problem in keeping up-to-date with changing and new accounting standards; and that the costs of keeping up-to-date with changing accounting standards are relatively higher for small firms than for large firms. Knutson and Wichmann (1984) found that accounting costs were twice as high for small companies as for large companies.

Other studies have found that small businesses have important differences in the financial awareness and skills (Sian and Roberts, 2003; Collis and Jarvis, 2002; Deakins et al., 2001). The evidence suggests that significant numbers of small businesses use fully or partially computerized accounting systems (Sian and Roberts, 2003, Collis and Jarvis 2002). It is

quite similar to Indonesia as a developing country for the SMEs that the small number of them use computer to make their financial statements and also have a little awareness to financial.

Therefore, it can be concluded that SMEs usually irregularly prepare financial statements. They think no other users want to know about their financial statements. However, it is important that they should prepare financial statements to know their own condition and also to develop their business.

### **The Need of Accounting and Financial Statements Based on Practices Perspectives**

The small medium enterprises have two kinds of problem such financial and non financial. Financial problem is related to lack of capability in SMEs to have capital to expand their business. Furthermore, non financial problem is related to the lack of management performance. Relate to financial problem, actually many banking will help to assist them to have capital. However, most of SMEs do not manage and financial report or financial statements with good quality. The financial as one of the components must make by SMEs, if they want to have credit through the banks. It is necessary for SMEs to record every business activities that occurred and also important to prepare financial statements.

Most of the small medium entities prepare their financial statements by their owner managers themselves or internally or bookkeepers by using a computerized package rather than they use or hire accountant or externally. Because the owner managers of SMEs have limited financial expertise so they do not use external accountants to assist in preparing their financial statements.

Based on theory, key users of financial statements for SMEs include investors, lenders, suppliers and other trade creditors, employees, customers, government (and their agencies or Bureau) and the public. However, not all of the users are important for SMEs, it can be concluded that the SMEs identify the main users of their financial statements are banks, managers,

and tax authorities. Chittenden et al. (1990) suggest that in most countries, the most important source of finance for small enterprises are banks. Berry et al., (1987); Berry et al., (1993) suggest that financial statements play an important role in their lending decisions. Jati (2004) suggest that most of the SMEs only record the amount of money received and spent, the amount of goods bought and sold, and the amount of receivables or debts. However, the recording is only limited to reminders only and not with the format desired by the banks. Although there is no doubt that they can know the amount of capital at the end of each year is quite if we recorded with the accounting system

The financial reporting or financial statements practices found in SMEs may not accord with mandate, recommended or preferred practices in some or all of a number of specific criteria such as:

- Not all financial statements may be prepared – preferably balance sheets, profit and loss statements and cash-flow statements should all be obtained, and both historical and future-oriented reports should be prepared.
- Financial statements may not be prepared with sufficient detail – preferably financial data should be provided on major segments of business.
- Financial statements may not be prepared appropriately – preferably generally accepted accounting principles should be followed, and the specific requirements of applicable accounting standards (the new Standard for SMEs), taxation law and corporations law should all be met.
- Financial statements may be prepared irregularly and/or infrequently – preferably financial statements should be routinely prepared at least annually, with monthly or quarterly reporting intervals being more appropriate.
- Financial statements may not be appropriately established – preferably financial statements should be validated by an independent external auditor annually.



- Financial statements may not be provided to all parties with reasonable expectations of receiving them as the users for instance non-managing owners, owner-managers, managers, key employees, creditors, financiers, advisers, taxation authorities and corporate regulatory bodies as needed, requested or mandated.
- Financial statements may not be used appropriately – preferably financial statements should be routinely analyzed and interpreted using accepted techniques for this purpose such as inspection of key figures, trend analysis, inter-firm comparisons and variance analysis.

It is important for government or other parties including Ministry of Cooperatives and SMEs, Indonesian Institute of Accountants (IAI) should concern for SMEs to give the information and short courses through education or training to prepare their financial statements. One intention in identifying the possible reasons for owner-managers of SMEs not facilitating more comprehensive financial reporting on their businesses is to establish that irrational behavior in an economic sense on the part of the owner-managers is not important to explaining this problem. It is necessary to make a habit of recording everything that is considered important for their business, so it will become easy, simple for owner managers of SMEs to prepare financial statement that is needed to them based on accounting standards with the easiest format apply.

### **The Role of The Indonesian Institute of Accountants (IAI) relate to Small Medium Enterprises (SMEs)**

Most accounting regulatory regimes recognize differences between larger and smaller enterprises and between those that are listed and unlisted and/or non-publicly accountable (Devi, 2003).

It is generally recognized that extant Indonesia financial reporting standards are aimed at larger organizations and developed from the viewpoint are the most important users. Therefore, such standards are not always appropriate for medium and smaller entities as the output is aimed at a different set of users with different needs and also the existence of “unique

SME factors, including close-knit agency relationships and a tendency to aim for survival and stability over profit maximization and growth” (Baskerville and Cordery, 2006, p. 2).

In Indonesia, we have one organization, the Indonesian Institute of Accountants (IAI) which has responsibility to make Accounting Standards. Today, IAI already issued Accounting Standard for Non-Public Accountability Entities (Standar Akuntansi Keuangan untuk Entitas Tanpa Akuntabilitas Publik). The standard for non-public entities will support small and medium enterprises in making good quality financial statements without the complexity of IFRS (International Financial and Reporting Standards) that we are adopting for the general accounting standards. Some of IFRS requirements are too complex for SME to comply with, this standard has less complexity, especially in measurement and disclosure requirements compare to IFRS. This standard is very important as most of the business entities in Indonesia are SME. The standard for private entities, or in Indonesian term SAK-ETAP, is developed based on IFRS for SME developed by IASB (International Accounting Standard Board), although not from the earliest version recently issued by IASB. SAK-ETAP is to be effective per 1 January 2011, however early adoption in 2010 is allowed. In conclusion, the SMEs should understand and make their own financial statements based on SAK-ETAP for their future.

### **The usefulness of financial statements**

Several usefulness of financial statements for SMEs are:

- for use as a decision tool;
- They provide useful information;
- They allow for comparability between periods and
- They can develop and increase their entity.

### **Conclusions**

Based on the explanation above, there are some conclusions include the SMEs may be prepared not all financial statements; SMEs may not be

prepared with sufficient detail to make financial statements; The SMEs's Financial statements may not be prepared appropriately based on Accounting Standard, Financial statements may be prepared irregularly and/or infrequently by the SMEs; the Financial statements of SMEs may not be provided to all parties; financial statements should be routinely analyzed and interpreted by SMEs.

### **Recommendations**

There are several recommendations in this paper such as:

- The government should give some kind of training for the SMEs. The government should provide a finance and taxation support system for the promotion of SMEs' technological innovation
- The owner managers of SMEs should concern to their company especially to prepare financial statements. It is important for them especially to have credit from Banking and to develop their business and they can know whether their position now is higher than their competitors for example in market share.
- The Indonesian Institute of Accountants (IAI) should socialize the Accounting Standard for Non-Public Accountability Entities especially to the SMEs in Indonesia.

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# CERTIFICATE



This is to certify that

**Lukiuk Fuadah and Anton Arisman**

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**Presenter**

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