The current issue and full text archive of this journal is available at
www.emeraldinsight.com/1176-6093.htm

Understanding financial information used to assess small firm performance

An Australian qualitative study

Abdel K. Halabi
Department of Accounting and Finance, Monash University, Churchill, Australia and
School of Accountancy, University of the Witswaterrand, Johannesburg, South Africa
Rowena Barrett
School of Management, Edith Cowan University, Perth, Australia, and
Robyn Dyt
Department of Accounting and Finance, Monash University, Churchill, Australia

Abstract

Purpose – The purpose of this paper is to investigate the reality of financial and management accounting in a small group of small firms. Specifically, from the owner's perspective, an exploration is undertaken to see what financial information is collected, how it is used (or not) to make business decisions and evaluate the firm's performance, and the role played by the accountant in that process.

Design/methodology/approach – A phenomenological paradigm underpins this exploratory study. Semi-structured interviews were undertaken with the owners of ten small firms, where the focus was on understanding what happens in an organisational setting, as opposed to theory and textbook practice.

Findings – The qualitative data supported prior research in other countries. The in-depth analysis revealed a very basic understanding of accounting information and problems with the financial literacy amongst these small firm owners. Accounting reports were not widely produced or used, so an informal assessment, such as how much cash was in the bank, was the primary means of assessing business performance. Accountants were used for taxation services, although some owners sought more general business advice.

Originality/value – An understanding is developed of why there might be a gap between textbook rhetoric and reality of accounting practice in small firms. The conclusion is that accounting textbooks need to include more information about the reality of financial management in small firms.

Keywords Financial information, Accountants, Australia, Small enterprises, Financial reporting

Paper type Research paper

The authors acknowledge the helpful comments made on earlier drafts of this paper by Professor Manzural Alam, Associate Professor Peter Carey, the two anonymous reviewers, and participants at the Small and Medium Enterprises – Entrepreneurship Global Conference, Melbourne, July 2008.

Qualitative Research in Accounting & Management
Vol. 7 No. 2, 2010
pp. 163-179
© Emerald Group Publishing Limited
1176-6093
DOI 10.1108/11766091011050840

Introduction

In developed and developing countries small firms make significant economic and social contributions. In Australia, small firms (those employing less than 20 people (Australian Bureau of Statistics (ABS), 2002)) represent the majority of all private sector firms. These 2,011,770 actively trading small firms employ over 3.6 million people (ABS, 2007) and contribute some A$300.15 billion per annum in turnover to the Australian economy, of which around A$28.21 billion represents operating profits before tax (ABS, 2007). Most of them are very small, employing less than five people, with two-thirds being either based in, or operated from, the owner's home (ABS, 2007). This is reflected in ownership structures, with around a third operating as sole traders (31 per cent), another third operating under a company structure (32 per cent), and the remaining third being split between partnerships (19 per cent) and trusts (18 per cent) (ABS, 2007).

Governments want people to start and grow firms and the requirements for start-up are minimal and depend on the business structure: a business or company name may need to be registered, a tax file number and an Australian business number may be needed (www.business.gov.au), and should the firm have sufficient turnover, then registration for goods and services tax (GST) would also be required. However, there are no legal requirements for nascent entrepreneurs to have any management skills; they only need a desire to be in business and a willingness to start trading. Yet management skills are critical to small firm survival (Storey, 1994) and the interest here is in the financial management aspect of operating a small firm. In particular, the question is: "What financial information is recorded within small firms and how is it used to inform business decisions?"

This is an interesting question as the majority of small firm owners are not legally obliged to produce accounting reports although they must record and report financial transactions for taxation purposes (Marriott and Marriott, 2000; Argilés and Slof, 2003). For those Australian small firms that operate as a sole trader business income must be reported on an individual tax return, while those operating as a partnership, (which is governed by the Partnership Act in their home state) must complete the partnership tax return for the business and the share of profit from the partnership is recorded on each partners' individual tax return. If a small firm is incorporated then it is governed by the Incorporations Act in their home state and the Commonwealth Corporations Act (2001) makes them legally responsible for producing accounting general purpose reports but only if they are a "reporting entity". "Reporting entities" must comply with the Australian Accounting Standards and lodge annual financial statements with the Australian Securities and Investments Commission[1]. CPA Australia's (2008) *Accounting Handbook* outlines the standard and format for these general purpose reports (profit and loss statement, balance sheet, cash flow statement and the statement of changes in equity). However, whilst small incorporated firms are required to produce these reports, they do not need to comply with accounting standards and therefore, do not have to produce reports with the same level of detail, unless they choose to do so.

If the majority of small firm owners are not "required" to produce accounting reports – and theory and textbooks suggests that a critical function of accounting reports is their usefulness in decision making (Ball and Brown, 1968; Horngren *et al.*, 2007) – then what is used to assess the firm's performance and how are decisions about the firm's future made? Do small firm owners use the financial information they collect for taxation purposes to inform their business decisions? Do they simply pass this information onto their accountant and hope for the best? What use is made of this data, if any? Understanding what happens in reality, rather than what "should" happen, is important, particularly as small business research to date has been inconclusive about the usefulness of financial information (Argilés and Slof, 2003).

The purpose of this study is therefore to examine what financial information small firm owners record and the system they use to collect, process and report that information. Other studies have considered whether the use of financial information is beneficial to firm performance (Thomas and Evanson, 1987; Lybaert, 1998; Argilés and Slof, 2003). Falling short of this, the purpose here is to understand what small firm owners do with information, which must be collected for tax purposes. As a result it is also necessary to look at the role of the accountant and explore how they work with the owner. These issues are explored in interviews with the owners of ten small firms in Victoria, Australia. Prior research has not used a phenomenological paradigm to examine these issues. In analysing this qualitative data, small firm owners' attitudes to the collection, use and interpretation of financial information are explored as well as the basis upon which they make decisions about their firm's performance. As such, acknowledgement is made of McMahon and Holmes' (1991, p. 27) point that perhaps what is known about financial management in small firms has been produced "from an inappropriate perspective – that of the technical specialist rather than that of the hard-pressed and pragmatic small firm proprietor". This study seeks to understand how different reality may be to what theory says or the "textbook view" (Vaivio, 2008) of financial management practices in small firms.

The remainder of the paper is structured as follows. In the next section the purpose of accounting is outlined as is the usefulness of accounting reports. A brief review of the literature identifies theory on and research into accounting reports, performance evaluation and the role of the accountant in relation to small firm management and we consider how this research can inform our study. The rationale for the study, the sample and the processes of collecting and analyzing the data is then outlined. In the findings section the qualitative data gathered in the interviews is presented in terms of how financial information is recorded, business performance is assessed and the role of accountants in this process. The findings are compared to the relevant theory and text book approaches previously outlined and the argument made that, while financial information and accounting reports can inform small firm owners of the consequences and impacts of their past decision making, they will only gain value from this information when they have the skills to read and understand it. Accountants can help owners understand the information they have as well as help them to apply it to their business decision making. The conclusion is that small firm owners (either on their own or with their accountants' support) need to develop their financial literacy skills if they are to reap business benefits from the financial information they record and collate for taxation purposes.

Accounting and financial information in small firms

Recording information

Accounting can be defined as "the information system that measures business activity, processes the information into reports, and communicates the results to decision-makers" (Horngren *et al.*, 2007, p. 2). This textbook view of the importance of accounting and accounting reports reinforces the view that financial information should be recorded and reported for the benefit of decision making and to inform external stakeholders (Altman, 1968; Ball and Brown, 1968; Libby, 1975). Most studies on the importance of accounting reports have been located in larger firms which are those that generally satisfy the "reporting entity" requirements. This is problematic as a range of studies of small firms reinforce that traditional accounting reports are of little use to business owners and probably because they are not well understood (Marriott and Marriott, 2000 citing Templeman and Wotton, 1987). Indeed, as Argilés and Slof (2003) argue, there is actually a general lack of empirical research to support the idea that accounting reports are a useful control mechanism in small firms.

Research suggests that not all smaller firms produce accounting reports despite the theorized performance benefits of doing so. For example, DeThomas and Fredenberger's (1985) study of 360 small firms in Georgia found 81 per cent produced summary financial reports and, of those, 91 per cent produced general purpose reports. Further, Thomas and Evanson (1987) examined 398 pharmacies in the USA and found that 62.5 per cent produced quarterly (at least) profit and loss statements and balance sheets. Dyt and Halabi' s (2007) survey of 86 micro firms and 35 small firms in Australia found a profit and loss report was produced in 65 per cent of the micro firms compared with 80 per cent of the small firms; a balance sheet was produced in 44 per cent of the micro firms compared with 74 per cent of the small firms; and a cash flow statement was produced in 26 per cent of micro firms compared with 34 per cent of small firms.

However, to produce accounting reports, a firm's owner requires some type of accounting information system which allows him or her to collect, process and produce those reports (Peirson and Ramsay, 2006). With the introduction of GST in Australia in 2000, such systems, where they exist, are becoming computerised (CPA Australia, 2003; Breen *et al.*, 2004). This has been facilitated by a range of off-the-shelf accounting software packages, which have been produced as cost effective solutions for small firms and easy to use by those who are not trained accountants (Breen *et al.*, 2004). Research shows that computerised accounting software in small firms is "predominantly used to produce financial statements such as the balance sheet (78 per cent), the profit and loss statement (76 per cent) and the cash flow statement (63 per cent)" (Breen *et al.*, 2004, p. 9). However, as accounting knowledge varies across firms, research has found that accounting software systems are often not used to their full potential (Marriott and Marriott, 2000; Ismail and King, 2007).

One of the benefits of accounting software is that it can be used to collect and collate information for the Australian Tax Office (ATO) (2002) which "records and explains" all business financial transactions. Each year, on a self-assessment basis, firm owners are responsible for submitting a taxation return that records all income and expenses and calculates the firm's annual profit or loss (ATO, 2008b, c, e, g). The individual, partnership, company or trust taxation returns would record totals of a number of similar type transactions, such as sales or service fees, bank interest received, wages paid (to non-owners), superannuation, utilities, cost of goods sold, opening and closing stock, capital gains for assets sold and special transactions. Cash accounting may be applied for taxation purposes whilst accrual accounting may more appropriately reflect business operations: that is, all cash received and paid may be advised to the ATO rather than the business transactions that occurred in the financial year. Further, individual taxation returns include all personal income and taxation deductions from non-business sources (ATO, 2008f). A taxation return, therefore, has some consistency with a basic profit and loss statement in that they both contain information that could be used by an owner to evaluate performance.

Financial management skills and performance evaluation
Research on small firms consistently finds that an owner's lack of financial skills can be a major impediment to business success (McMahon and Davies, 1994; McMahon and Holmes, 1991; McMahon, 1999; Marriott and Marriott, 2000; McMahon, 2001a, b; 2003; Gooderham *et al.*, 2004), suggesting that there is a wide gap between the "textbook theory" and the day-to-day reality of financial management practices.

McMahon and Holmes (1991, p. 19 citing Potts, 1977, p. 2) note 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". Their review of North American literature found evidence of significant adoption of accounting systems but limited use of the information found in these reports. DeThomas and Fredenberger (1985) also found that while 81 per cent of the firms they studied produced summary financial reports, only 11 per cent used that information in their decision making despite 61 per cent of them feeling it could be used for planning and decision making. However, from their study of Catalan farmers, Argilés and Slof (2003) concluded that financial reports could be beneficial for decision making, but only when the expected performance gain of doing so was significantly larger than the cost of obtaining those reports. Clearly this is problematic for smaller firms.

So what do small firm owners use to make assessments of how their business is performing? While the answer will depend on the owner's conception of "success" and their motivation for business, small firm owners have been found to place a "major emphasis" on financial goals and to use financial information to evaluate firm performance (Perera and Baker, 2007). Other research in larger organizations (Altman, 1968) points to the analytical quality of ratio analysis in performance evaluation. This may explain why ratios analysis is often a major topic in most accounting textbooks (Horngren *et al.*, 2007). For small firms, profitability, cash-flow and ratio analyses can be effective measures of success although research is unclear on the extent of their wider use (Hall and Fulshaw, 1993; Jennings and Beaver, 1997). DeThomas and Fredenberger (1985) found that only 2 per cent of small firms in their study performed financial ratio analysis, while Argilés and Slof (2003) found ratio analysis was widely used amongst their farming sample.

Commentary about business survival pinpoints the importance of cash flow and cash management (Welsch and White, 1981; Khan and Rocha, 1982; Chaganti and Chaganti, 1983). Indeed, UK research has found that a focus on cash flow is more likely to be associated with firm survival (Jarvis *et al.*, 1996; Deakins *et al.*, 2002). "Money in the bank" was found by Dyt and Halabi (2007) to be a critical measure of firm performance. These performance measures all rely on some financial data being recorded. As CPA Australia's (2003) research found, owners of small firms who are effective record keepers have fewer difficulties meeting their taxation obligations, make fewer mistakes and have more information available to manage their business (Chaganti and Chaganti, 1983).

Role of the accountant
The traditional role for an accountant has been to provide assistance with record keeping and the production or review of taxation compliance reports (CPA Australia, 2003;

Breen *et al.*, 2004; Gooderham *et al.*, 2004; Carey *et al.*, 2005). Increasingly though, small firm owners are using their accountant for business advice and support (Jay and Schaper, 2003; Bennett, 2007; Dyer and Ross, 2007) and evidence suggests that those who purchase such advice from their accountant perceive their business performance to be better than their competitors (Carey *et al.*, 2005). This extra support is more likely to be obtained at the same time as the accountant deals with the owner's statutory accounts (Collis and Jarvis, 2000). Whether the advice is taken depends on the quality of the relationship between the accountant and business owner (Gooderham *et al.*, 2004; Dyer and Ross, 2007). Indeed, Marriott and Marriott (2000) suggest accountants could increase their role and the demand for their services by increasing their clients' financial skills and by providing narratives on the financial information in their clients' taxation reports.

Since the introduction of the 10 per cent GST, taxation recording has become more complicated and prompted small firms to make greater use of their accountant's services (Dyt and Halabi, 2007). The GST is a tax collected on many sources of business income and paid out on business outgoings. Some business items are GST-free and so these must be identified separately. A regular (monthly, quarterly or annual) GST taxation return must be produced, although not necessarily for firms with an income level below $75,000 (ATO, 2008d). The business activity statement (BAS) details the sources of income for which GST was received and payments for which GST was paid (ATO, 2008a). These GST amounts are not a business tax or a source of business income; rather, they are a way the firm's owner collects taxation on behalf of the government. As such, the BAS is not a source of information for business assets, business loans or business ownership; rather, it is a summary for GST for the BAS period (ATO, 2008a).

Small firm owners perceive the GST to be a burden on their time (Murphy and Petzke, 2002). In acknowledgment of this, the government has made amendments to the system. However, despite the costs, "three quarters of small businesses claim that compliance obligations act as an incentive to keep up-to-date with record keeping and that they run financial reports regularly to manage the business" (CPA Australia, 2003, p. 6).

Accounting texts and theory state that the collection and collation of financial information to produce accounting reports will be useful for decision making and conveying information to external parties. However, for many small firm owners there is no requirement, except for taxation purposes, to convey financial information to others and, consequently, financial reports are not widely produced. Given this, the purpose of this study is to understand whether small firm owners use the information they collect for taxation purposes to help them make business decisions and manage their firm's performance. Moreover, as accountants have traditionally played a role in preparing taxation returns, this research will further understanding of when and why small firm owners use accountants' services beyond taxation compliance.

Methodology

Saunders *et al.* (2003, p. 84) note that the business world and management are "too complex to lend [themselves] to theorizing by definite law". A phenomenological paradigm is adopted to enable understanding of behaviour from the participant's own frame of reference. Discovery of what Remenyi *et al.* (1998, p. 35) call "the details of the situation" will enable the generation of an understanding of the participant's reality. As Saunders *et al.* (2003, p. 84) argue, "it is necessary to explore the subjective meanings motivating people's actions in order to be able to understand these".

Such thinking is increasingly becoming accepted in accounting research (Ahrens, 2004; Humphrey and Lee, 2004; Modell and Humphrey, 2008; Vaivio, 2008), while it is accepted and widely applied in the small business context (Curran and Blackburn, 2001; Grant and Perren, 2002; Perren and Ram, 2004). In small firms, the boundary between "the firm" and "the owner" is not always clear: what goes on within the small firm is often reflective of, and attendant on, the owner's skills and capacity as well as their attitudes and values. This is not only true of accounting practices (Dang Duc *et al.*, 2006) but of other areas more generally (Lewis *et al.*, 2007).

For this exploratory study, semi-structured interviews were used to collect qualitative data from the owners of ten small firms over a four month period from January 2007 till April 2007. All participants had previously participated in a survey on similar issues (Dyt and Halabi, 2007) but were randomly selected for the present study from those respondents who indicated on their returned questionnaire their willingness to participate further. In interviews, examples of hypothetical accounting reports (in their standardised formats) were shown to interviewees and used as basis for discussing what financial information was recorded, who was involved in the production of reports (i.e. what role their accountant played) and how that information was used. Interviews offered a unique opportunity to explore the many points of views on the topic (Miller and Glassner, 1997), and enabled a "fresh slant" (Irvine and Gaffikin, 2006) to be gained of the owner's means and modes of financial record keeping, how they evaluated business performance and how they used their accountant's services. In essence they allowed going beyond the "textbook view" of accounting (Vaivio, 2008). The interviews took place at a location nominated by the owner, lasted approximately one hour, were tape recorded and transcribed before being returned to the interviewee for validation as a true and accurate record of the interview.

Analysis was guided by Tesch's (1990) assertion that no standard analysis procedure exists for qualitative data. Instead, analysis can be a "fluid" process of making sense of the data. The analytic approach was partly intuitive with the transcriptions being reviewed for common themes and relationships between them categorized (O'Dwyer, 2004). A computer assisted qualitative data analysis software package was used to help identify keys words and then categorise the text into themes for sorting. Similarities and differences were found in terms of how each interviewee described what happened in their business. As such, the data was analysed according to of the meanings owners attached to issues which were identified within the data, with reference to broader contexts.

Results

The ten small firms were all located in rural Victoria (Australia), represented a cross-section of industry and had been operating for five to 27 years (see Table I for demographic details). Although four firms operated through a private company structure, their operations were not significant enough for them to be considered "reporting entities". None were required to produce accounting reports and taxation was the only context in which the firm's financial performance needed to be reported.

Accounting reports

Of the ten firms, five had owners who stated that accounting reports were not produced for or used in their firm, primarily as they did not understand financial information. As one owner said, "the information is only useful if you can understand it. I find the

Table I.
Participants

	Gender	Ownership structure	No. of owners	No. of employees	Years in business
Agricultural Services Provider	M	Private company	1	1	6
Business Consultant	F	Trust	2	1	25
Farmer	M	Partnership	2	0	42
Financial Services Provider	M	Private company	1	3	8
Health Services Provider	M	Private company	2	6	21
Real Estate Agent	M	Partnership	2	5	27
Restaurateur	M	Trust	2	2	6
Retailer No. 1	M	Sole trader	1	3	5
Retailer No. 2	F	Private company	1	3	16
Tradesperson	M	Trust	1	0	25

financial reports have too much detail generally" (Health Services Provider). The inability to read accounting language or understand common terms and conventions used in accounting reports was problematic for some. For example, when looking at the example of a profit and loss statement, one retailer said:

> See this, you get lost in all this chartered numbering thing and opening stock, all that, that's very confusing. I don't even look down here when they get into this kind of perforated Profit and Loss and little brackety things, it's too hard (Retailer No. 2).

Accounting reports and taxation returns utilise similar information but look different. One owner thought the figures in a profit and loss statement were not a true reflection of his business transactions, but rather amounts that could be claimed for taxation purposes. Whilst the veracity of this could not be ascertained, it was this owner's perception of the report's lack of usefulness which was the issue:

> With respect to Profit and Loss Statements, to me they're just an arbitrary figure. They're not a true reflection because it's a book entry at the end of the financial year so you've got your taxation and all that but to me they're not that accurate (Financial Services Provider).

For the five firms who produced and used accounting reports this was a relatively new initiative. For one owner, it was because "I've just changed my accountant and that's why I'm getting this Profit and Loss, I wasn't getting one before" (Farmer). While this owner used an accountant to prepare his taxation returns, he did not receive a balance sheet report nor was he aware that such a report existed. The farmer was told that the value of land (which could differ to the value at the time of acquisition), farm machinery, quantity of livestock and outstanding loans could be reflected on a balance sheet. When this was explained in the interview, the farmer said:

> So, are you saying this would be done by an accountant? I think everybody should have what you've got here [. . .] I'd be interested in this [and] my figures on it. That's what simple people like me need (Farmer).

Computerised recording of financial information

Data must be recorded appropriately to obtain accounting reports. Six owners used an off-the-shelf accounting package. As one owner stated, "Yeah the computer will throw out almost what you want it to do" (Real Estate Agent). The ability to make comparisons across time periods with ease was beneficial for those who used such systems: "You can look at the last two years and say, 'oh, well, the last two years have ended up being roughly the same.' Or you go back the year before that and see if it was way down" (Retailer No. 1). Another owner also commented on the benefits of comparisons saying, "You can look at last year's figures with a push of a button and compare them with this year's figures and ask 'Am I travelling all right?'" (Agricultural Services Provider). For another, computerisation made decision making and planning easier: "From my computer I get the previous year's actual figures, and budget based on that rather than projecting forward. [. . .] I see whether I can get anywhere near that [. . .] knowing what the seasonal influences are" (Agricultural Services Provider). This could be contrasted to one owner who relied on a manual system:

> It would be good on the computer, to know more about stock, [. . .] I can go back to last year's invoices and say "okay I spent $$$$$ dollars, I spent $$$$ with that company" [. . .] And where there is no computer, you rely on your memory entirely. You know, computers would be marvelous on a stock control issue (Retailer No. 2).

Computerisation allowed timely reports to be produced as well as ones that the owner trusted to be "correct": "I know that if I pull out my gross profits and balance reports, and Profit and Loss statements, and all those sort of things that no worries at all, I know what comes out of the computer is going to be right" (Retailer No. 1). Despite this it was acknowledged that it took skill to interpret reports:

> It's never obvious out of the reports you get whether I should hold my sales where they are and work on reducing my costs or I should do the same turnover (Retailer No. 1).

Performance evaluation

The investigation sought to determine how these owners assessed their firm's performance irrespective of the way they recorded financial information or whether accounting reports were produced. Knowing their cash position was the dominant theme running throughout the interviews: "We look at the balance in the bank account" (Health Services Provider); "You look at your bank statement [. . .] there's so much money involved in farming that you do need to have your bit of a finger on the pulse, and know the cash balance" (Farmer). One of the retailers looked at the cash flow and cash position on a daily basis: "We look at it every day. We have a spreadsheet running all the time so I know exactly what's going to happen" (Retailer No. 1). This was made easier by technology for another owner who said: "Internet banking has made it very easy to keep an eye on what's coming in and going out, and I check very regularly (the bank balance) on the Internet" (Restaurateur).

Three owners explained that they analysed information in accounting reports in order to make decisions. Two indicated that some form of ratio analysis was conducted. As one said, "I compare my figures to last year and also as a percentage also [. . .] [I compare] expenses as a percentage to turnover" (Retailer No. 1). The other reported, "I've been able to work out what the break even is on the average for the week per year" (Business Consultant).

One of the owners explained how their financial skills had improved over time and how they used current financial information to underpin their future plans and budgets:

> Even though I'm just a small business, I'm now at the stage where I'm generating budgets not only for what are we going to do in turnover, what projected turnover, but advertising, wages and the phone bill. I'm now budgeting for all those sort of things (Retailer No. 1).

Another owner explained that he used his reports to tell the story of the business, saying, "You start analysing why it is that you haven't done better, or why it is that you've done well. It's a matter of sitting down and looking at the figures and saying, oh, what is it actually telling me?" (Agricultural Services Provider). Finally, another owner explained, "There's no sense in doing a lot of testing and measuring without seeing what results it achieves and the only place you can see the results is in your figures" (Retailer No. 1).

These comments could, however, be contrasted with the Tradesperson who again preferred cash and said:

> At the moment, for me, whether I'm going good, bad or indifferent is totally unquantifiable – I don't know. I've got no idea. Am I going worse than last year? I don't know. I've got money in my pocket. My bank account's bigger than it was last year. There's stuff in the pipeline. But to be able to put actual figures on it, I don't know [. . .] I don't need to keep records of it.

The role of the accountant

Each of the owners employed an accountant whose major role they agreed was to help them comply with their statutory taxation obligations. For the Tradesperson, who operated a "shoe box" system, the accountant's role was to summarise transactions for the financial year: "What goes to the accountant, is essentially this bag full of bits. I have these manila folders with all the paperwork, and that goes to the accountant [. . .] in a summarised book". His response to the interviewer's question, "And you've got your income on one side, payments on the other?", was: "That's right. They're all jumbled up. But they come out to a figure".

Three owners had purposefully changed their accountant in order to find someone who could provide them with financial and taxation advice:

> It actually came down to changing accountants because we just felt that our previous accountant wasn't giving us the information we really wanted or needed and we found ourselves basically having to continually ask him questions and then he'd give us the information but if we hadn't asked the question we wouldn't have got this information (Restaurateur).

As another explained:

> What I want from him [the accountant] is a statement on how he thinks my business is going [. . .] a second opinion [. . .] They'll pick up on things that I'll miss. I'll pick up on things that they won't think relevant, but I know they're important to my business (Retailer No. 1).

This owner went onto say, "The accountant is the first person you should be dealing with outside your business" (Retailer No. 1). Similarly the restauranteur outlined the relationship with his accountant and how valuable a different set of ideas could be:

> Our new accountant is completely different. He'll ring me up on the spur of the moment type thing and just say, I've noticed you're not doing this [. . .] Like for instance in the last quarter our wages had gone up as a percentage of turnover had gone up, and he brought that to our attention. It made us realise that maybe we had been overstaffing. He's been fantastic for the business. Yeah, I would speak to him at least once a fortnight (Restaurateur).

Whilst accountants' professionalism in providing taxation services was not raised, what did emerge as a concern was understanding the information they provided: "They're too busy spending as little time as possible with you to get on with the job of helping you make sense of it" (Agricultural Services Provider). Another owner said, "You don't know what to ask, you just usually walk out of the accountants with no idea what they were talking about" (Retailer No. 2). This owner also put it a different way, saying, "You get in and you get out as quick as you can, it's like going to see a dentist or a doctor" (Retailer No. 2). The problem was expressed by one owner as being "a function of the system" when it was said that:

> Accountants have a proforma for doing tax returns, they drop in the figures as they go, that's it, that's what's presented to the customer. Even if walk around the corner and ask the guy for his tax return, probably 95 per cent of it will be in exactly the same format (Retailer No. 1).

This owner went on to say:

> If it was me, what would be done for the Tax Department would be to fill in one page, that's it. The other 13 or 14 pages should be a report on how my business is. And that's how it should be (Retailer No. 1).

The introduction of GST was seen as having some benefits:

> I guess when they first bought the GST in, I thought, that's too much work [. . .] but, okay, you need to look at the flip side and say there is something positive about being a non-paid collector of taxes for the government – use that information, and start making some decisions as to how you're travelling and focus on all that (Agricultural Services Provider).

Discussion

Poor management skills can be a factor in small firm failure, while poor accounting systems can also be a contributory factor. However, there is no compulsion for the majority of small firm owners to report financial transactions except in the context of taxation. The GST has meant an increase in the frequency and level of reporting to the ATO and as a result, in many small firms recording systems have been upgraded and accountants' services have been employed. Despite this, it is not clear how much use is made of financial information beyond taxation compliance. The purpose of this study was therefore to understand whether and if financial information used to produce taxation returns was also used to help make business decisions. How do small firm owners use financial information to assess their firm's performance and what role does their accountant play in this process?

While others have looked at the relationship between the use of financial reports and firm performance, the driving interest for this study was to look at the "reality" of what happens in regards to recording and using financial information and comparing that to what textbooks suggest should happen (Vaivio, 2008). By undertaking interviews with owners of ten small firms, who gave in-depth explanations of their financial recording and reporting practices, the focus was on "learn[ing] about the context of these practices" (Lillis, 2008, p. 240). In general, standard accounting reports were not widely used, although for the few who did use them, this was a recent occurrence. This conflicts with the accepted view of the usefulness of accounting reports (Ball and Brown, 1968), but conforms with other research that has questioned whether such reports are useful for small firms which do not need to report to external parties.

This Australian study therefore confirmed findings in other similar economies reported by others (such as DeThomas and Fredenberger, 1985; Marriott and Marriott, 2000; Argilés and Slof, 2003).

During interviews when examples of accounting reports were shown to interviewees, some confessed to being unable to read them or reported finding them too difficult to read to be of any use to them. Indeed one owner was unaware that such reports could be produced. Discussions suggested that people felt these reports did not reflect "real" business figures because they were "produced for the taxman", implying that the figures were deliberately kept low to reduce the amount of taxation to be paid.

The lack of reliance on the accounting reports led to the next question. How do these small firm owners assess their performance? Computerised accounting systems were seen as valuable as they made it easier to monitor and compare costs between different time periods. However, it was the cash at bank balance which was generally considered to be an accurate reflection of "real" performance – a finding others have also reported (Welsch and White, 1981; Khan and Rocha, 1982; Chaganti and Chaganti, 1983; Jarvis *et al.*, 1996; Deakins *et al.*, 2002; Dyt and Halabi, 2007). Indeed, one owner took considerable steps to know the daily bank balance. Generally though the focus was on "money in the bank", and those who produced accounting reports or summarised their income and expenses on a regular basis also took this into consideration. Some use was made of ratios and analysis of the figures in the accounting reports, although this was not done in any depth.

All ten owners employed an accountant to assist them with the preparation of taxation reports, and they considered this to be the accountant's primary role, which confirmed prior studies (CPA Australia, 2003; Breen *et al.*, 2004; Carey *et al.*, 2005; Gooderham *et al.*, 2004). Those who received more from their accountant appreciated and valued that assistance in analysing their firm's performance (Jay and Schaper, 2003; Bennett, 2007; Dyer and Ross, 2007). However, they had to ask their accountant for this assistance and for some this was not possible as they had "no idea what the accountant was talking about", were either "too embarrassed" to ask for assistance or did not "know the questions to ask".

On the question of whether financial information was used to evaluate their firm's performance the owners gave mixed responses. Positive responses suggested that they looked at the information "more often than [they] used to", that they were "more up to date in recording" and that "each quarter [they] have a snapshot of how [their firm was] performing". However, negative responses included that they "don't understand reports", "reports are for the tax department" and reports were "a nuisance". In essence, the value gained from the recording of financial information depended on the owner's financial skill, and their relationship with their accountant.

Others have considered the accountant's role in taxation compliance for small firms (CPA Australia, 2003; Breen *et al.*, 2004; Carey *et al.*, 2005). In this study, accountants were not found to be helping their clients to understand their firm's performance by translating the information needed to comply into a form that could be used within the business. Should the accountant do this or does the owner need to improve their financial literacy skills? Perhaps it is a vicious circle: owners who lack these skills do not know what to ask and this limits their accountant to providing taxation compliance services rather than helping to develop their client's financial management skills.

Conclusion

A key feature of accounting reports is said to be their usefulness in making business decisions, yet many small firm owners are not required to produce accounting reports and instead need only to prepare (or have prepared for them) an individual or business taxation return. This drives the collection of financial information. In Australia the introduction of GST has seen more sophisticated financial management systems being implemented in these firms. On what basis are business decisions made, if they are not based on the information in accounting reports? This is explored through interviews with owners of ten small firms: what financial information do they collect, how is it used and what role is played by their accountant in that process?

The study has a number of implications. While owners of small firms are not required to produce accounting reports, those with "better" financial literacy skills are more likely to use accounting information. While not a feature of this study, ideally whether these firms perform better as a result needs to be establsihed. It does, however, suggest that increasing the financial literacy skills of the firms' owners would be beneficial.

While owners of small firms should take some responsibility for their own financial literacy skills there is also a role to be played by their accountant. Comments made by interviewees reflected negatively on accounting and the accounting profession. Accountants can do more than simply provide a taxation compliance service. They should also provide a basic accounting analysis service for their clients at a negligible or affordable cost. However, it raises the question as to whether small firm owners would be prepared to pay more to their accountant for additional information?

Finally, the study points to an inconsistency between practice and what many accounting textbooks say, which is the importance of accounting and accounting reports for business decision making and performance evaluation. Most accounting textbooks take a large firm focus as these have external stakeholders to whom reports must be made. Accounting reports contain information used by external decision makers. Without these external stakeholders, for many small firms this information is not relevant. The particular circumstances and issues facing small firms and the value given to, and reliance of, owners on alternative forms of financial information needs to be made apparent to accounting students, so they may work more effectively with these sorts of clients in the future.

There are of course limitations to this study. However, these limitations can provide a basis for further research. Only interviewed were owners of ten (very) small firms and, in general, these owners were experienced, having been in business between five and 27 years. Extending the research to a larger sample could be desirable in order to enhance the generalisability of the findings. That said, the results presented here are not dissimilar to what others have found, either in Australia or in other similar countries.

The firms operated across a range of industries, from retail to services to farming, where the motivations for business and pressures to perform are different. An important distinction in future research would be examining businesses in similar industries – the small firm sector is so heterogeneous that further industry-specific research might highlight specific concerns for different groups of owners. The firms in the present study were also located in a particular region of Victoria where access to accounting services, whilst similar, might be limited more generally, and this could impact on the availability of "extra" advice. In sum, these serve to limit the generalisability of the findings. However, the aim of this research was to explore what financial information was recorded, how and why from the small firm owners' perspective.

Further research could also assist in resolving a number of dilemmas. For example, if computerised accounting systems can produce accounting reports then why are they not produced and used more within small firms? Is it an issue of format or financial literacy skills? Or is it a function of the relationship with the accountant? What role should an accountant play in helping their small firm client interpret financial information? Future research could focus on whether the taxation services that accountants provide their small firm clients actually satisfies their needs.

Financial management skills are critical to the survival of small firms. Despite this the majority of owners of small firms do not (as yet) need to comply with any specific accounting standards and must only report financial information for taxation purposes. Financial information and accounting reports can inform owners of the consequences of their firm's operations and the impacts of their past decision making. It can be used to help owners grow and develop their firm and thus, strengthen the economic and social contribution small firms can make.

Note

1. Reporting entities do not necessarily have to be incorporated, instead the *Accounting Handbook* defines them as having operations of significant economic, political or financial concern (CPA Australia, 2008). This would, however, exclude the majority of non-incorporated small firms.

References

ABS (2002), "Small business in Australia 2001", Cat. No. 1321.0, AGPS, Canberra.

ABS (2007), "Counts of Australian businesses, including entries and exits, June 2003 to June 2007", Cat. No. 8165.0, AGPS, Canberra.

Ahrens, T. (2004), "Refining research questions in the course of negotiating access for fieldwork", in Humphrey, C. and Lee, B. (Eds), *The Real Life Guide to Accounting Research: A Behind the Scenes View of Using Qualitative Research Methods*, Elsevier, Oxford, pp. 295-307.

Altman, E.I. (1968), "Financial ratios, discriminant analysis and the prediction of corporate bankruptcy", *Journal of Finance*, Vol. 23, pp. 589-609.

Argilés, J.M. and Slof, E.J. (2003), "The use of financial accounting information and firm performance: an empirical quantification for farms", *Accounting and Business Research*, Vol. 33 No. 4, pp. 251-73.

ATO (2002), *Tax Basics for Small Business: An Overview of Your Tax Obligations and Entitlements When Running a Small Business*, AGPS, Canberra.

ATO (2008a), "Business activity statement", NAT 4191-7.2004, Australian Taxation Office, Canberra.

ATO (2008b), "Business and professional 2008 items schedule for individuals", NAT 2816-6.2008, Australian Taxation Office, Canberra.

ATO (2008c), "Company tax return 2008", NAT 0656-6.2008, Australian Taxation Office, Canberra.

ATO (2008d), "GST for small business", NAT 3014-07.2008, Australian Taxation Office, Canberra.

ATO (2008e), "Partnership tax return 2008", NAT 0659-6.2008, Australian Taxation Office, Canberra.

ATO (2008f), "Tax return for individuals 2008", NAT 2541-6.2008, Australian Taxation Office, Canberra.

ATO (2008g), "Trust tax return 2008", NAT 0660-6.2008, Australian Taxation Office, Canberra.

Ball, R. and Brown, P. (1968), "An empirical evaluation of accounting income numbers", *Journal of Accounting Research*, Vol. 6, pp. 159-78.

Bennett, R.J. (2007), "Expectations-based evaluation of SME advice and consultancy: an example of business link services", *Journal of Small Business and Enterprise Development*, Vol. 14 No. 3, pp. 435-57.

Breen, J., Sciulli, N. and Calvert, C. (2004), "The role of the external accountant in small firms", *Small Enterprise Research*, Vol. 12 No. 1, pp. 5-14.

Carey, P., Simnett, R. and Tanewski, G. (2005), "Providing business advice for small to medium enterprises. A report prepared for CPA Australia", available at: www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FEDF-B0F51943/cpa/hs.xsl/726_15818_ENA_HTML.htm (accessed 22 January 2006).

Chaganti, R.W. and Chaganti, R. (1983), "A profile of profitable and not-so-profitable small businesses", *Journal of Small Business Management*, Vol. 21 No. 3, pp. 126-37.

Collis, J. and Jarvis, R. (2000), "How owner-managers use accounts", Research report, ICAEW, London, available at: www.icaew.com/index.cfm/route/157846/icaew_ga/en/pdf (accessed 13 May 2009).

CPA Australia (2003), "Small business survey program: compliance burden", CPA Australia, Melbourne, available at: www.cpaaustralia.com.au/cps/rde/xbcr/SID-3F57FECB-6E6E157 A/cpa/survey_compliance_burden.pdf (accessed 13 May 2009).

CPA Australia (2008), *The Accounting Handbook*, Vol. 1, Pearson Australia, Melbourne.

Curran, J. and Blackburn, R.A. (2001), *Researching the Small Enterprise*, Sage, London.

Dang Duc, S., Marriott, N. and Marriott, P. (2006), "Users' perceptions and uses of financial reports of small and medium companies (SMCs) in transition economies: qualitative evidence from Vietnam'", *Qualitative Research in Accounting & Management*, Vol. 3 No. 3, pp. 218-35.

Deakins, D., Morrison, A. and Galloway, L. (2002), "Evolution, financial management and learning in the small firm", *Journal of Small Business and Enterprise Development*, Vol. 9 No. 1, pp. 7-16.

DeThomas, A.R. and Fredenberger, W.B. (1985), "Accounting need of very small business", *CPA Journal*, Vol. 55 No. 10, pp. 14-23.

Dyer, L.M. and Ross, C.A. (2007), "Advising the small business client", *International Small Business Journal*, Vol. 25 No. 2, pp. 130-51.

Dyt, R. and Halabi, A.K. (2007), "Empirical evidence examining the accounting information systems and accounting reports of small and micro business in Australia", *Small Enterprise Research*, Vol. 15 No. 2, pp. 1-9.

Gooderham, P.N., Tobiassen, A., Døving, E. and Nordhau, O. (2004), "Accountants as sources of business advice for small firms", *International Small Business Journal*, Vol. 22 No. 5, pp. 1-19.

Grant, P. and Perren, L. (2002), "Small business and entrepreneurial research: meta-theories, paradigms and prejudices", *International Small Business Journal*, Vol. 20 No. 2, pp. 185-211.

Hall, G. and Fulshaw, S. (1993), "Factors associated with the relative performance amongst small firms in the British instrumentation sector", in Klandt, H. (Ed.), *Entrepreneurship and Business Development*, Aldershot, Avebury, pp. 227-37.

Horngren, C.T., Harrison, W.T., Bamber, L., Best, P.J., Fraser, D.J. and Willett, R. (2007), *Accounting*, 5th ed., Pearson Education, Sydney.

Humphrey, C. and Lee, C. (2004), "The real life guide to accounting research: a strategy for inclusion", *Qualitative Research in Accounting & Management*, Vol. 1 No. 1, pp. 92-100.

Irvine, H. and Gaffikin, M. (2006), "Getting in, getting on and getting out: reflections on a qualitative research project", *Accounting, Auditing & Accountability Journal*, Vol. 19 No. 1, pp. 115-45.

Ismail, N. and King, M. (2007), "Factors influencing the alignment of accounting information systems in small and medium sized Malaysian manufacturing firms", *Journal of Information Systems and Small Business*, Vol. 1 Nos 1-2, pp. 1-20.

Jarvis, R., Kitching, J., Curran, J. and Lightfoot, G. (1996), "The financial management of small firms – an alternative perspective", ACCA Research Report No. 49, Association of Chartered Certified Accountants, London, available at: www.accaglobal.com/publicinterest/activities/research/reports/smallbusiness_research/rr-049 (accessed 13 May 2009).

Jay, L. and Schaper, M. (2003), "Which advisors do micro-firms use? Some Australian evidence", *Journal of Small Business and Enterprise Development*, Vol. 10 No. 2, pp. 136-43.

Jennings, P. and Beaver, G. (1997), "The performance and competitive advantage of small firms: a management perspective", *International Small Business Journal*, Vol. 15 No. 2, pp. 63-75.

Khan, M.R. and Rocha, J.R. (1982), "Recurring management problems in small business", *American Journal of Small Business*, Vol. 7, pp. 50-8.

Lewis, K., Massey, C. and Harris, C. (2007), "Learning by doing: six dimensions of complexity in researching SMEs", *Qualitative Research in Accounting & Management*, Vol. 4 No. 2, pp. 151-63.

Libby, R. (1975), "Accounting ratios and prediction of failures: some behavioral evidence", *Journal of Accounting Research*, Vol. 13 No. 1, pp. 150-61.

Lillis, A. (2008), "Qualitative management accounting research: rationale, pitfalls and potential. A comment on Vaivio (2008)", *Qualitative Research in Accounting & Management*, Vol. 5 No. 8, pp. 239-46.

Lybaert, N. (1998), "The information use in a SME: its importance and elements of interest", *Small Business Economics*, Vol. 10, pp. 171-91.

McMahon, R.G.P. (1999), "Financial reporting to financiers by Australian manufacturing SMEs", *International Small Business Journal*, Vol. 18 No. 1, pp. 35-52.

McMahon, R.G.P. (2001a), "Business growth and performance and the financial reporting practices of Australian manufacturing SMEs", *Journal of Small Business Management*, Vol. 39 No. 2, pp. 152-64.

McMahon, R.G.P. (2001b), "Growth and performance SMEs: the influence of financial management characteristics", *International Small Business Journal*, Vol. 19 No. 3, pp. 10-28.

McMahon, R.G.P. (2003), "An exploratory study of under- and over-investment amongst manufacturing SMEs from Australia's business longitudinal survey", *International Small Business Journal*, Vol. 21 No. 1, pp. 29-53.

McMahon, R.G.P. and Davies, L.G. (1994), "Financial reporting and analysis practices in small enterprises: their association with growth rate and financial performance", *Journal of Small Business Management*, Vol. 32 No. 1, pp. 9-17.

McMahon, R.G.P. and Holmes, S. (1991), "Small business financial management practices in North America: a literature review", *Journal of Small Business Management*, Vol. 29 No. 2, pp. 19-29.

Marriott, N. and Marriott, P. (2000), "Professional accountants and the development of a management accounting service for the small firm: barriers and possibilities", *Management Accounting Research*, Vol. 11, pp. 475-92.

Miller, J. and Glassner, B. (1997), "The 'inside' and the 'outside' finding realities in interviews", in Denzin, N.K and Lincoln, Y.S. (Eds), *Handbook of Qualitative Research*, Sage, Thousand Oaks, CA, pp. 99-112.

Modell, S. and Humphrey, C. (2008), "Balancing acts in qualitative accounting research", *Qualitative Research in Accounting & Management*, Vol. 5 No. 2, pp. 92-100.

Murphy, D. and Petzke, S. (2002), "A survey of small regional businesses and the impact of the goods and services tax (GST)", Working Paper 31/02, Faculty of Commerce, Charles Sturt University, Wagga Wagga.

O'Dwyer, B. (2004), "Qualitative data analysis: illuminating a process for transforming a 'messy' but 'attractive' 'nuisance'", in Humphrey, C. and Lee, B. (Eds), *The Real Life Guide to Accounting Research: A Behind the Scenes View of Using Qualitative Research Methods*, Elsevier, Oxford, pp. 391-407.

Peirson, G. and Ramsay, A. (2006), *Financial Accounting: An Introduction*, 4th ed., Pearson Education, Frenchs Forest.

Perera, S. and Baker, P. (2007), "Performance measurement practices in small and medium size manufacturing enterprises in Australia", *Small Enterprise Research*, Vol. 15 No. 2, pp. 10-30.

Perren, L. and Ram, M. (2004), "Case study method in small business and entrepreneurial research", *International Small Business Journal*, Vol. 22 No. 1, pp. 83-101.

Remenyi, D., Williams, B., Money, A. and Swartz, E. (1998), *Doing Research in Business and Management*, Sage, London.

Saunders, M., Thornhill, A. and Lewis, P. (2003), *Research Methods for Business Students*, 3th ed., Pearson Education, Harlow.

Storey, D. (1994), *Understanding the Small Business Sector*, Routledge, London.

Tesch, R. (1990), *Qualitative Research: Analysis Types and Software Tools*, The Falmer Press, London.

Thomas, J. and Evanson, R.V. (1987), "An empirical investigation of association between financial ratio use and small business success", *Journal of Business Finance & Accounting*, Vol. 14, pp. 555-71.

Vaivio, J. (2008), "Qualitative management accounting research: rationale, pitfalls and potential", *Qualitative Research in Accounting & Management*, Vol. 5 No. 1, pp. 64-88.

Welsch, J.A. and White, J.F. (1981), "A small business is not a little big business", *Harvard Business Review*, Vol. 59 No. 4, pp. 18-32.

Corresponding author
Abdel K. Halabi can be contacted at: abdel.halabi@buseco.monash.edu.au

To purchase reprints of this article please e-mail: **reprints@emeraldinsight.com**
Or visit our web site for further details: **www.emeraldinsight.com/reprints**