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# Accounting Standards Harmonisation Dilemna and Its Impact on Access to Credit in Zimbabwe, a Case of Harare Small to Medium Manufacturing Enterprises, Zimbabwe

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**Abstract:** The purpose of the study was to analyse the accounting standards of Small to Medium Enterprises in Harare, Zimbabwe in order to reveal their strengths and weakness in obtaining external funding. The study's instruments were the questionnaire and the interview guide. Mixed analysis was used and it involved the use of both quantitative and qualitative analytical techniques within the same framework, which is guided either a priori, some posteriori, or iteratively (representing analytical decisions that occur both prior to the study and during the study).The objective of the study was to examine whether financial institutions can offer financial support basing on their accounting records. The value of this study was that it revealed that SMEs were aware of accounting standards that governed the operations of SMEs but were not following any recognisable accounting standards.The research design was a descriptive survey. The study' findings revealed that Small to Medium Enterprises in Zimbabwe play a major role in employment creation. Findings also revealed that financial institutions were reluctant to offer SMEs financial support due to their high degree of informality, non verifiable financial statements and also lack of collateral security. The study recommends that SMEs should adhere to proper accounting standards so as to increase their chances of accessing financial support from banks and other lending institutions.

**Keywords:** SMEs, Accounting, Finance, Zimbabwe.



## INTRODUCTION

Financial reporting may be defined as communication of published financial statements and related information from a business enterprise to third parties (external users) including shareholders, creditors, customers, governmental authorities and the public (Lin & Yu, 2012). It is the reporting of accounting information of an entity (individual, firm, company, government enterprise) to a user or group users. Company financial reporting is a total communication system involving the company as issuer (preparer); the investors and creditors as primary users, other external users; the accounting profession as measures and auditors and the company law regulatory or administrative authorities (Farouk, 2015). Firstly, the cost of developing specialized reports to satisfy special requirements of specific users may exceed the benefits when the company financial reporting policy is determined in its totality. Secondly, specialized needs of specific users cannot be ascertained with any degree of certainty. Thirdly, issuing multiple reports about the financial results of an enterprise can create confusion among various users. Fourthly, multiple reports may not be desirable and practicable from the standpoint of information economics (Floridi *et al.*, 2014).

### Harmonization

Harmonization simply means maintaining uniformity in financial accounting uniformity in financial accounting standards and practices at the international level (Floridi *et al.*, 2014). It implies international harmony in transactional financial reporting to investors. It emphasizes to narrow the areas of difference and to eliminate undesirable alternative practices in financial reporting. Uniformity expedites the training of accounting of accounting practitioners, increases the reliability of accounting reports and tends toward a rational development of accounting theory. Flexibility, the opposite of uniformity, allows better adaptability of accounting methods in each firm, each industry, or each type of transaction. Besides, the absence of a single method provides scope for further experimentation. New and better theories may result. As international trade and investment multiplies, accounting's international dimension broadens. Due to growth in trade across national frontiers, international financial reporting has become more important as the

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tool of communication among traders, entrepreneurs, financiers, ad investors. At the same time, variations are evolving in accounting principles, audit practices, financial statement presentations, and professional standards. If accounting reports are to become a universal means of communication, action must be taken to harmonies the worldwide efforts to meet the international user's needs (Ikechukwu, 1993).

**The Need for Standards**

The increased globalisation of corporations and finance has spurred a trend to harmonize accounting standards between countries. This move aims to enhance consistency and in turn ease the process of comparison of performance between companies registered in different territories. Accounting standards are needed so that financial statements will fairly and consistently describe financial performance. Without standards, users of financial statements would need to learn the accounting rules of each company, and comparisons between companies would be difficult.

**Standard Setting Bodies**

Accounting standard setting bodies are national or international organisations that have been delegated responsibility for setting Generally Accepted Accounting Principles by statute in a country or jurisdiction.

**Standards in Accounting**

The term 'Accounting Standard' may be defined as written statements issued from time to time by institutions of the accounting profession or institutions in which it has sufficient involvement and which are established expressly for this purpose. Accounting standards deal mainly with financial measurements and disclosures used in producing a set of fairly presented financial statements. In this respect, accounting standards can be thought of as a system of measurement and disclosure. They also draw the boundaries within which acceptable conduct lies and in that and many other respects; they are similar in nature to laws. Accounting standards can thus be seen as a technical response to calls for better financial accounting and reporting; or as a reflection of a society's changing expectations of corporate behaviour and a vehicle in social and political monitoring and control of the enterprise. Accounting standards, however, do not aim to put accounting in a straight jacket. Rather, they attempt to limit the theoretically possible flexibility and to give practitioners realistic working guidelines. Accounting standards are classified into a number of categories as shown in the discussion below.

**Adherence to Standards by SMEs**

Accounting Standards (AS) are basic policy documents. Their main aim is to ensure transparency, reliability, consistency, and comparability of the financial statements. They do so by standardizing accounting policies and principles of a nation/economy. So the transactions of all companies will be recorded in a similar manner if they follow these accounting standards.

**Attainability of Standards, That is, The Ease With Which it is Possible to Achieve The Standards**

Accounting systems are responsible for 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, (Eric & Gabriel, 2012). In the context of SMEs, accounting information is important as it can help the firms manage their short-term problems in critical areas like costing, expenditure and cash flow, by providing information to support monitoring and control (Braggrus, 2017).

**Ideal Theoretic Standards**

Ideal standards (costs) are the standards which can be attained under the most favourable conditions possible. The level of performance under ideal standards would be achieved through the best possible combination of factors — the most favourable prices for materials and labour, highest output with best equipment and layout, and maximum efficiency in the utilisation of the production resources—in other words, maximum output at minimum cost. Such standards reflect only goals or targets without any hope of performance being currently achieved. These standards are extremely tight and do not provide for waste and inefficiency in any form; no material is wasted; no units are spoiled; there are no idle hours; operators work at predetermined speeds; the available capacity is fully utilised. The ideal standard represents the ultimate goal to strive for, but its attainment is impossible over sustained periods. It sets its sights on the stars.

**Normal Standards**

Normal standards are the average standards which (it is anticipated) can be attained during a future period of time, preferably long enough to cover one business cycle. Standards are set on a normal capacity basis which represent a volume that averages out the company's peak and slack periods. Constant unit costs are employed throughout the cycle, regardless of changes in current costs or selling prices.

These standards are not revised until the cycle has run its full course. This generally results in an incorrect valuation of inventories and consequent errors in the profit disclosed as the inventories are understated in periods of high prices, and overstated when prices are low. Since these standards do not reflect the goals to be attained, they are not often used.

**Basic Standards**

Braggrus, (2017) defines a basic standard as the standard which is established for use unaltered for

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an indefinite period which may be a long period of time. Basic standards are seldom revised or updated to reflect current operating costs and price level changes.

Basic standards representing a fixed base are used primarily to measure trends in operating performance. Although useful, basic standards must be adjusted before they can be used for performance evaluation purposes. They can be based upon any capacity level that is selected initially to develop the standards.

**Currently Attainable or Expected Actual Standards:**

Current standards are standards which are established for use over a short period of time, and are related to current conditions. They represent current costs to be expected from efficient operations. These standards do not anticipate ideal performance; they are difficult, but possible to achieve.Currently attainable standards are formulated after making allowance for the cost of normal spoilage, cost of idle time due to machine breakdowns, and the cost of other events which are unavoidable in normal efficient operations. They take the place of actual cost and are recorded in account books and financial statements. Any deviation from these standards reflect inefficiencies in the production activities, unless the variances have occurred due to uncontrollable factors. Currently attainable standards are revised to reflect changes in methods and prices. Much effort and costs are involved in developing these standards. Based on engineering estimates, currently attainable standards are most expensive of the four types of standards. But these standards are most accurate and very useful to management in product costing, inventory valuations, estimates, analyses, performance evaluation, planning, employee motivation, and for managerial decision-making and external financial reporting.

Thus main objective of operating an SMEs in Zimbabwe is poverty alleviation through employment of members of the public A study of SMEs Manufacturing Sector in Harare, Zimbabwe is therefore critical given their immense contribution to country through payment of presumptive taxes and employment creation. The main formal financing source for SMEs is the bank. According to the European Central Bank (2011), 40% of respondent firms use their overdraft facilities or credit lines, and more than one-third of firms have used bank loans. Farouk (2012) mentions that commercial banks are the primary providers of debt capital to firms. Commercial banks prefer firms with proven track records and sufficient collateral in the form of hard assets. Proven track records and collaterals are difficult to obtain for small businesses. The lack of access to bank loans of SMEs is attributed to information asymmetry. Finance gap hypothesis suggests that SMEs suffer from a shortage of financing, which is caused by information asymmetry Asechimie (1992); & Bukaliya & Aleck (2012) mention that lending in developing economies, specifically lending to micro and small enterprises, is particularly affected by information asymmetries between borrowers and lenders. Thus, startups and expansion potentials cause difficulties in obtaining intermediate external financing, which depend mainly on internal financing or informal external financing such as friends and family. Constraints on external financing are significant issues, and SMEs use internal financing as a fallback option (Bukaliya & Aleck, 2012). Thus SMEs entities should start to take a serious issue of harmonise their accounting records so as for them to obtain external funding and avoid compulsory taxes such as presumptive taxes by the government.

**EXPERIMENTAL SECTION/ MATERIAL AND METHODS**

**Statement of the Problem**

Demand for proper accounting records which complies with international accounting standards by external financiers without taking into consideration lack of knowledge to prepare them, high costs of employing knowledgeable people, punitive taxes among others, by SMEs had led to the assumptions that SMEs is a risk business with no access to funding. Is there need any need to invest where banks require verifiable finance statements in order to offer SMEs financial support?

**Objectives of the Study**

To assess impact of accounting standards practices and their effects on access to external funding by SMEs, based on a study of hundred and fifty (150) SMEs manufacturing sector staff, in Harare

**Research Question**

Do the issue of accounting standards harmonisation with internal standards on SMEs in Harare, Zimbabwe has a major effect when external financiers want to extent funding to them?

## METHODOLOGY

The population of the study consisted of 150 (one hundred and fifty) members from Harare, informal manufacturing SMEs staff drawn from business owners, bank accounting staff, auditing and managers from Ministry of Small to Medium Enterprises. A mixed method approach was used to assess the main cause of rejecting accounting records given by SMEs .A purposive approach to select 50 (fifty) members was used for the study as it enabled the researcher to consciously select a sample appropriate for the Study . The study's instruments were the questionnaire and the interview guide.

## RESULTS AND DISCUSSION

The study sought to find out the impact of failure to adopt internationally accepted accounting standards by Small to Medium enterprises basing on

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failure to access capital from external financiers. The following results were obtained

**Table 1.** Impact of non-adherence to internationally accounting standards by SMEs Manufacturing

| Impact of non-adherence to international accounting standards | Agree | Not Sure | Disagree |
|---|---|---|---|
| Do you require harmonised accounting standards to offer loan as banks or external financiers? | 90% | 5% | 5% |
| Is there issue of standards for SMEs to qualify for tax exemptions? | 85% | 5% | 15% |
| Is there inadequate knowledge by SMEs personnel to prepare books of accounts? | 80% | 15% | 5% |
| Do you encounter liquidation problems as a result of non preparation of books of accounting? | 80% | 12% | 8% |
| Collapsing of SMEs entities is common because of non funding by banks because of poor accounting records? | 90% | 5% | 5% |
| Does the non production of accounting records has an effect on the economy? | 80% | 10% | 10% |

Source: Primary data 2022

Majority of respondents agreed (90%) that there is need to prepare harmonised accounting standards so that banks can offer them financial assistance with a minority in disagreement (5%) and (5%) not sure.

Thorough understanding of SMEs Manufacturing sector, in Harare Zimbabwe and impact on non-harmonisation provided by the respondents included collapse of entities due to non-financial support, compulsory punitive taxes such as presumptive on them, among other problems.

**Does The Issue of Non-Adherence to Accounting Standards have an Impact on the Performance of SMEs?**

The research intended to establish whether non adherence has an impact on the performance of SMEs Manufacturing sector the following results were obtained:

**Question 1:** Do non adherence with international accounting standards by SMEs has an effect on SMEs financial performance?

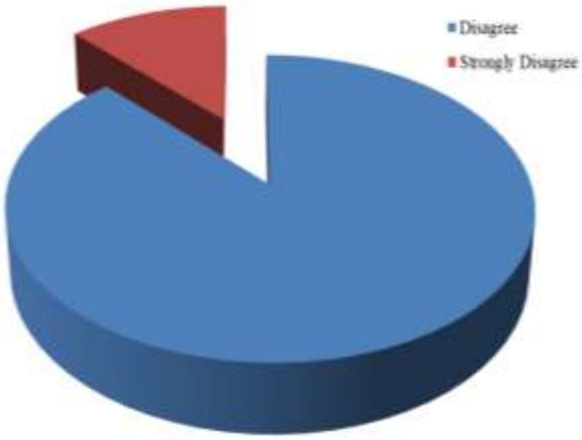


**Fig 1:** Do non adherence with international accounting standards by SMEs has an effect on SMEs financial performance?
Source: Primary data 2022

Interviews data obtained with the SMEs Manufacturing sector indicated that there is a link (80%) between non adherence to international accounting standards and performance of the entities. Many SMEs collapsed as a result of not aware whether they were making profit or not Members of the SMEs indicated that they were conversant with the obligation of preparing verifiable accounting records so that bank could extend any credit facilities and also for calculation of taxes by the government. More to that one of the informants said "*…it is justifiable for banks not to offer credit facilities on non-verifiable accounts which do not comply with international accounting standards".*

It was also noted that data gathered through questionnaires concurs with data collected from interviews. Thus, this indicated that the respondents were aware of the impact on non-adherence to international accounting standards, thus causing them to be imposed compulsory punitive tax such as presumptive tax, no financial support due to non-verified accounting records, collapsing of entities as a result of poor knowledge of whether one is making profit or not among other problems.

Harmonisation of accounting standards directly influences the financial performance of an organisation or entity as they determine key issues such as financial support by the banks, liquidity position of the firm, rate of return and proper calculation of taxes by the government. The main aim of organisations is to make sure that their clients be it internal or external is satisfied through offering of continuous service. Lack of knowledge on the preparation of accounting records had led to the wrong view that operating SMEs is a risk business and will collapse in no distant future.

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# FINDINGS

The study revealed that the majority of the informal enterprises in Harare did not keep financial records and did follow proper accounting standards practices. Findings also revealed that financial institutions were reluctant to offer SMEs financial support due to their high degree of informality and also lack of collateral security, thus it complies with the understanding at the continental level. The Insurance companies were not able to give proper service delivery because Banks wanted verifiable financial statements before they could extend any credit facilities to the informal SMEs. The compulsory registration for presumptive tax was very prohibitive for most of this small business as they were forced to the tax even when they were not making any profits.

# CONCLUSIONS

The study concluded that SMEs must fulfil their side of contract by preparing accounting records that are in Harmon with international standards. Publication or presentation of financial records to external financiers must not be hindered by lack of knowledge by SMEs personnel.

**Recommendations**

The study recommended that SMEs should adhere to proper accounting standards so as to increase their chances of accessing financial support from banks and other lending institutions.

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