

SIMPLIFIED MODELS FOR THE PREPARATION AND PRESENTATION OF SMALL AND MEDIUM ENTERPRISE (SME) FINANCIAL STATEMENTS

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Abstract

The immense contributions by the Small and Medium Enterprises (SMEs) to national income has necessitated a model format for the preparation and presentation of Annual Reports and Financial statements for the SMEs. The models suggested in this paper are geared towards improving the quality and usefulness of financial statements prepared and presented by the SMEs. The models will also serve as guide to Accounting Standards Setter (Nigerian Accounting Standard Board — (NASB) when formulating Financial Reporting Standards for Smaller Entities (FRSSE) in Nigeria. The article is of the view that SME operators or managers should be transparent as far as practicable when-disclosing information to users of their financial statements.

Introduction

Accounting or financial information about a business enterprise large or small, is required by a variety of user. This need dictates the fundamental objectives of accounting and the mode of reporting information. Moreover, firms, or enterprises carry on business activities in a given and dynamic economic, social and political environment and there is public interest in their operations. For instance:

Individuals, financial institutions or group of investors need accounting or financial information to determine the liquidity, profitability and viability of the enterprise.

- i. Business managers and owners need accounting information to measure performance, plan and control operations, and to make good business decisions.
- ii. Employees and customers of an enterprise need accounting information in order to assess the ability of the enterprise to produce goods or to render services on a continuous basis.
- iii. Governments and regulatory agencies need accounting information in order to be able to impose and collect taxes, to regulate certain business activities and to plan, execute and evaluate public projects (SAS 2).

Financial statements as means of communicating to interested parties, information on the resources, obligations and performances of the reporting entity or enterprise are expected to be simple, clear and easy to understand by all users, according to the 'SAS No.2 on Information to be Disclosed in Financial Statements.' Information contained in financial statements are usually prepared according to generally accepted accounting principles (GAAP). GAAPs require the use of accruals method of accounting. However, there is a question of whether GAAP is applicable to small and medium enterprises (SMEs) and whether GAAP, meets the needs of these enterprises, as well as of the preparers and the users of their financial reports. The next part of this article examines the meaning of SME, the sources of fund available to the SME, problems associated with the preparation and presentation of SME Financial Statements followed by suggested models for application - using hypothetical figures.

The Meaning of Small and Medium Enterprise (SME)

Defining the term 'small and medium enterprise (SME)' is not an easy task. At first, this appears very easy to answer. But a closer look contradicts this belief. As one visit many of these places of business—such as barbing saloons, small shops or stores, dry-cleaners, video and record rental shops, dentist, private clinics, maternity houses, fast-food restaurants, estate valuers and other professional offices, etc, one would find that defining small business or SME is not an easy task (Udi and Omorokpe: 2006). It therefore depends on how individuals view it. Some firms may be big when viewed on itself, but small when compared with other companies in the same industry. Such company can safely be classified as a small business or small company.

Different schools of thoughts and writers on business have offered varied definitions of small and medium enterprise using such indices as:

- a. Total investment cost,
- b. Level of turnover,
- c. Size of the workforce, as decided by labour leaders,
- d. Independently owned and operated,
- e. Not dominant in its area of operation,
- f. Does not engage in new or innovative practices.

Viewing it from the present Nigerian industrial situation, small-scale enterprise could be defined as a business entity that has less than one million Naira (₦1,000,000) total assets value, and with not more than twenty (20) employees. It could be safely assumed as observed that the Nigerian economy is largely dominated by small and medium scale businesses. They are established and run by individuals, groups, families, co-operatives or as companies. It is important to note that most large companies started small.

Because of SME crucial role in economic development of a nation, it becomes very important to have a standard definition of small-scale enterprise to act as a guide to both financial operators and owners of such business activities. To this end, the Bankers' Committee on SME-Nigeria (2005) comes out with a definition of Small and Medium Enterprise. It defines SME as 'any enterprise with a maximum asset base of five hundred million Naira (₦500 million), excluding land and working capital, and with no lower or upper limit of staff.

Definitions in this field of endeavour change over time, and more importantly, depend upon a nation's level of development. But relevance to Nigeria, the Companies and Allied Matters, Act (CAMA) -2004, as amended, stipulates that a company qualifies as 'small company' if it satisfies the following conditions in a given year:

- a. It is a private company having a share capital,
- b. The amount of its turnover for that year is not more than ₦2 million or such amount as may be fixed by the Corporate Affairs Commission (CAC),
- c. The net assets value is not more than ₦1 million or such amount as may be fixed by the Commission,
- d. None of its members is an alien,
- e. None of its members is a Government or a Government Corporation or agency or its nominee, and
- f. The directors between them hold not less than 51 per cent of its equity share Capital" (CAMA, 2004, section 351).

Sources of Funds

If a business is to operate effectively and expand, it needs an appropriate level of assets, and therefore a flow of cash (funds) into the business with which to acquire the assets. The sources of such cash must be capital or liabilities or both, and the various forms of funding available to SME are as follows;

- a. Short- term credit (e.g. Current Liabilities)
- b. Long-term borrowings (e.g. Long-term Liabilities)
- c. Capital introduced by owners/shareholders
- d. Profit generated by the business.

Examples of Current Liabilities are:-

- Trade creditors - for goods purchased on credit by the entity.
- Accrued charges for services enjoyed but not yet paid for (e.g. Electricity bills)
- Taxation payable, i.e. Tax due to the government but not yet settled.
- Bank overdraft, i.e. money borrowed from bank on current account so that interest is charged only on the amount outstanding each day. It is a form of stand-by credit.

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- Dividends payable (by incorporated businesses) i.e., money set aside out of profit but not yet paid to the shareholders or owners.

Examples of Long-term Liabilities are:-

- Creditors for goods or equipment bought on hire purchase (H P), lease etc.
- Secured and unsecured bank loans and other Long-term loan.
- Debentures, which are securities issued by a limited Liability company for money borrowed on the company's fixed assets or properties having a fixed rate of interest and usually fixed redemption (repayment) date. HP is an example of direct reduction loan which requires the borrower to repay the principal and the interest in uniform installments throughout the life of the loan.

Profit

Profit is the most important source of fund for the growth of business. To make profit, it is necessary to have achieved an excess of Income over Expenditure so profit means additional cash, which means additional assets. Note that profit belongs to the owners of the business, and so increases their capital.

Capital

This means the actual amount of money or money worth brought into the business by the proprietor or entrepreneur from his outside interest, or private savings. The capital of a limited liability company is termed the ordinary or equity share capital. The capital of an existing business consists of the assets (what is owned by the business) less the liabilities (what is owed by the business to others). It is a long-term resource of the enterprise.

It should be noted that the financing source that is common to all forms of business enterprises- incorporated or unincorporated, is 'trade credit'. Trade credit is buying goods or receiving services on credit.

Problems Associated With SME Financial Statements Preparation and Presentation

The major problems that may hinder the preparation and presentation of SME financial statements process include;

- a. lack of skill in finance and accounting,
- b. Inadequate financial records.

Skill in Finance and Accounting

Most small business owners lack the necessary skill in finance and accounting. 'It is true to say that if you do not understand finance and accounting, you will not be successful in convincing financial institutions to lend you money and you will not reach your full potential' (Webbs,2001:66). It is important that business people understand the basic process of bookkeeping and accounts, as it is often said that accounting is the language of business.

Inadequate Financial Records

There is paucity of essential financial record in small business enterprises in most developing countries. Adequate financial records are essential prerequisite for granting loan applications by Banks and other Financial Institutions, for example. It also enables both internal and external parties to evaluate the business performance from time to time, and at the end or death of the business.

Suggested Model of Financial Statements for SMEs

Accounting to the UNCTAD (2003); Guidelines on Accounting and Financial Reporting for Small and Medium-scale- Enterprises, the minimum set of primary financial statements that must be presented by SME include the following components:-

- a. A Balance sheet,
- b. A profit and loss account (or an income statement) and
- c. Explanatory notes (or notes to the accounts, i.e., financial statements).

The guidelines went further by saying that enterprises may wish to include other statements that are likely to enhance the overall transparency and quality of the enterprise's provision of information to users, for example, a cash flow statement.

A cash flow statement is a classified list of the origins and destinations of cash receipts and cash payments with a business enterprise. From such a list, an insight can be gained into the liquidity, viability and financial adaptability of the business together with its cash generating and absorption mechanisms thus providing a basis for the assessment of future cash flows. Activities found most often in such statement are operating activities, investing activities and financing activities. SAS No. 18 (Nigeria) requires that a statement of cash flow should be part of the financial statements prepared by an organization.

When preparing financial statements for SME, the following procedures should be followed:

1. Financial statements should be prepared on a going-concern basis unless management either intends to liquidate the enterprise or cease trading or services, or has no realistic alternative but to do so.
2. Simplified accruals basis of accounting should be used when preparing enterprise financial statements.
3. The name of the enterprise and the period of accounts, that is, reporting period should be prominently displayed on the Balance sheet and the profit and loss account (income statement) and/or any other relevant statement to be presented. This is in accordance with the 'entity' and the 'periodicity' concepts in accounting.
4. Financial statements should be presented at least annually. This is also a requirement of the Companies and Allied Matters Act (CAMA), 2004, as amended.
5. The enterprise should present current and non-current liabilities as separate classification on the face of the Balance sheet. A non-current liability is another term for Long-term liabilities such as loan or other form of debt that is of Long-term duration.
6. A statement in the form of schedule of fixed assets, should accompany the Balance sheet, indicating the year or period, column for disposal during the year, column for gross amount or cost, depreciation amount and the net book value (NBV) of the assets at the end of the period.
7. An item of property, plant and equipment (PP&E) should be measured at its costs. The costs include purchase price, import duties (if imported) and any directly attributable costs for its intended use, any trade discount and rebate are deducted in arriving at the purchase price (SAS3). Value Added Tax (VAT) must also be excluded.
8. Movement on owner's equity should be disclosed during the financial year.
9. The term 'turnover' should be used to describe the total sales revenue of a trading enterprise net of discount, while the term 'Gross income or Gross earnings' should be used for service rendering enterprises. VAT must be excluded
10. Inventories (stocks-in trade) should be measured at the lower of cost and net realizable value, that is, the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.
11. The cost of inventories should comprise all costs of purchase and other costs (such as transport and manufacturing) incurred in bringing the inventory to their present location and condition.
12. Inventories should be valued using the first-in-first-out (FIFO) or simple or weighted average method. The last-in-first-out (LIFO) or Latest purchase price methods must not be used (SAS No.4).
13. Revenue from rendering of services should be recognized to the extent that the service has been provided.
14. Where there is uncertainty as to the recovery of trade debt, a reasonable provision should be made against trade debts. Such provision must be specific. A general provision is not permitted by the tax authority.
15. Any significant gains or losses should be disclosed separately.

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16. The term 'cost of operation' should be used for service rendering enterprise for all costs incurred, while 'cost of sales' should be used to describe the direct operating costs of a trading enterprise.
17. A reconciliation of Accrued Expenses (Accruals) and prepaid expenses (prepayments) should be carried out at year end using the following formats:

Accruals schedule for 20x8 - Using hypothetical figures

Details	Balance brought forward (opening)	Provision addition during the year to profit & loss	Balance carried forward (closing)
e.g.	₦'000	₦'000	₦'000
1. Rates	300	200	100
2. Wages, etc	5,000	4,000	1,000
TOTAL	5,300	4,200	1,100

The total balance at close (cf) is represented in the Balance sheet as Accruals under current liabilities.

Prepayment Schedule for 20x8 - Using hypothetical figures

Details	Balance brought forward	Payments during the year	Charges to profit & loss account	Balance carried forward (close)
e.g.	₦'000	₦'000	₦'000	₦'000
1. rent (name and address of landlord)	2000	3,000	4,000	1,000
2. Telephone	500	1000	1,100	400
Total	2,500	4,000	5,100	1,400

The total balance carried forward (c/f) is represented in the Balance sheet as prepayments under current assets.

Annex 1

Model Profit And Loss Account - Where the Enterprise is a Trading Enterprise

Abu Limited

Profit and loss Account for the year ended 31 December, 20x8

	₦'000	₦'000
Turnover		40,000
Less cost of sales:		
Opening stock	5,000	
Add Purchases	<u>15,000</u>	
Goods available for sale	20,000	
Less Closing stock	<u>4,000</u>	<u>16,000</u>
Gross profit		24,000
+ other Income, decrease in bad debt, etc (if any)		<u>500</u>
		24,500
Deduct Expenses (Indirect costs):		
Salaries and wages	7,000	
Depreciation	2,000	
Lease rent (if any)	4,000	
Motor vehicle expenses	<u>1,500</u>	
Insurance and rates	<u>1,200</u>	

Telephone	2,100	
Electricity	1,300	
General expenses	<u>400</u>	<u>20,000</u>
Profit before Interest and other financial costs	4,500	
Less Interest and other financial expenses		<u>300</u>
Profit after interest and other financing costs		4,200
Less Tax (estimated at 30%)		<u>1,260</u>
Profit after tax for current year		2,940
Profit and loss brought forward		<u>560</u>
Profit and loss carried forward (retained earnings)		<u>3,500</u>

Annex 2

Model Income Statement (for a Service Rendering Enterprise)

Omos & Co Income Statement for the Year Ended 31st December 20x8

	N'000	N'000
Gross earning or income		20,000
Less Cost of operations		<u>13,000</u>
Net profit before tax		7,000
Less Tax (estimated at 30%)		<u>2,100</u>
Net profit after tax		<u>4,900</u>

Annex 3

Model Balance Sheet

Abu Limited Balance Sheet as at 31st December 20X8

	N'000	N'000	N'000
Assets		Accumulated	
Fixed assets	Cost	Depreciation	
Land & Buildings	3,000	500	2,500
Plant & machinery	2,000	400	1,600
Motor vehicles	1,500	600	900
Furniture & fittings	<u>500</u>	<u>100</u>	<u>400</u>
Total	<u>7,000</u>	<u>1,600</u>	5,400
Current assets			
Stocks		2,600	
Debtor (Net of provisions)		500	
Prepayments		1,400	
Cash		<u>200</u>	
Total Current assets		4,700	
Less Current liabilities			
Trade creditors	600		
Accruals	1,100		
Bank overdraft	400		
Proposed dividends (if any)	-	<u>2,100</u>	
Net Current assets			<u>2,600</u>
Net assets (Total)			<u>8,000</u>

Liabilities

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Authorized capital

6,000,000 Ordinary share of N1 each

6,000

Paid -up capital		
3,000,000 Ordinary shares of ₦1 each		3,000
+ Retained Earnings		<u>3,500</u>
Shareholders' fund		6,500
Non -current liabilities		<u>1,500</u>
Capital employed		<u>8,000</u>

Annex 4

Model Balance Sheet Format for Unincorporated Enterprise (Where the Enterprises is Not a Limited Liability Company)

	₦'000	₦'000	₦'000
Assets			
Fixed assets			
Land and Buildings		2,000	
Less Accumulated depreciation		<u>100</u>	1,900
Plant & Equipment		1,000	
Less Accumulated depreciation		<u>200</u>	<u>800</u>
Total Net fixed assets			2,700
Current Assets:			
Stock		50	
Debtors	500		
Less Provision for bad debt	<u>50</u>	450	
Prepayments		50	
Bank balance		30	
Cash on hand		<u>20</u>	
Total Current assets		600	
Less CURRENT LIABILITIES:			
Trade creditors	150		
Bank overdraft	50		
Tax payable	40		
Accrued expenses	<u>60</u>	<u>300</u>	
Net Current assets (working capital)			<u>300</u>
Total Net assets			3,000
Liabilities:			
Owners' capital			2,500
Profit (loss) for the year		1,300	
Less Drawings for the year		<u>1,100</u>	
Increase in owner's capital			<u>200</u>
Owner's capital at close			2,700
Add Non-current liabilities: long-term loans			<u>300</u>
Total owner's capital and liabilities			<u>3,000</u>

Notes

Annex I and 3 on model of profit and loss account and Balance sheet respectively are drafted in accordance with the provisions of section 350, CAMA, 2004 which permits the presentation of modified financial statements for small companies by directors,

Conclusion

Financial statements are summaries of gains and losses incurred by the enterprise during the course of its business and investment activities. They are sometimes referred to as 'final accounts'. The proprietors or shareholders, the tax authority and banks need to see financial statements prepared

by business enterprises. Anyone considering buying the business also needs to see the financial statements. Information contained in these statements must be reliable and easy to understand.

Financial statements presented by SME must reflect, as much as possible, a true picture of the financial results and position of the business enterprise at the close of a year or a particular period. Certain transactions which overlap the closing date have to be adjusted. This takes the form of dividing the sum involved in each year ending, and the new financial year about to begin. The nature of the business must be given careful consideration before adopting any of the suggested formats in Annex 1 to 4 above.

Recommendations

This article strongly recommend that the Nigerian Accounting Standards Board (NASB), the apex regulator of accounting practice in Nigeria, should come up with a statement on Financial Reporting Standard for Smaller Entities that will guide the preparation and presentation of SME financial statements. Such standard should ensure that the resulting financial reports are understandable, reliable, and relatively consistent between comparable reporting periods. Understandability is one of the qualitative characteristics of financial statements. If the financial information is not understood by users, it can not be used and thus cannot have value.

Finally, SME operators or managers on their part should be transparent as far as practicable when disclosing information to users of their financial statements.

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