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The Impact of Financial Reporting Practices on Performance: A Study of Small and Medium Enterprises in Rathnapura District, Sri Lanka

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Abstract

The objective of the study is to examine the impact of financial reporting practices on the financial performance of small and medium enterprises (SMEs) in Rathnapura District, Sri Lanka. This empirical study is based on the primary data through face to face interviews and administered questionnaires and secondary data through examining subject related books, published research papers, websites, statistical reports of the Central Bank of Sri Lanka and other institutions, and their specific regulatory factsheets. Data were collected from the total selected sample of 60 SMEs Statistical tools; hypothesis testing, descriptive statistics, and Multiple Regression Analysis are used to analyze and find the result of the study. The designated measures of financial reporting practices are financial reporting practices, investment analysis practices, Inventory management practices, cash management practices, and fixed assets management practices. The findings revealed that among the five selected independent variables, there was a variation of 93% (Approx.) of the financial performance of SMEs due to changes in financial reporting practices, investment analysis practices, inventory analysis practices, cash management practices and fixed assets management practices that have been depicted in the model. Out of five variables, FR, IA, and FA management practices are highly supported to better financial performance than that of the INA and CM practices. This paper provides useful information to the Government Ministries, Central Bank of Sri Lanka, Professional Bodies SME owners, researchers, accounting practitioners and other stakeholders in Sri Lanka for their involvement in making efforts to the future development of SMEs.

Keywords: Financial reporting practices, Financial performance, Small and Medium Enterprises, Rathnapura District

Introduction

Financial reporting practices play an important role in the success or failure of contemporary SME institutions. These practices are utilized for recording, analyzing, monitoring and evaluating the financial condition of SMEs, preparation of various kinds of documents necessary for decision-making purposes, regulatory requirements, tax computation and payments, providing information support to many other organizational functions [Chapman, 1997]. Accounting systems provide a source of information to owners and managers of SMEs operating for the use in measuring financial performance [Uddin *et al.*, 2017]. In this juncture, financial reporting practices involve the disclosure of financial information to the various stakeholders; investors, creditors, public, debt providers, governments and government agencies on the financial performance and financial position of the organization. The Government of Sri Lanka, Central Bank of Sri Lanka (CBSL) and the Institute of Chartered Accountants of Sri Lanka (ICASL) in associations with many other business and professional bodies have issued various accounting standards and guidance to apply for financial reporting to SMEs. This ensures uniformity across various diversified industries when they prepare and present their financial statements. According to the International Accounting Standard Board (IASB), the objective of financial reporting is "to provide information about the financial position, performance and changes in the financial position of an enterprise that is useful to a wide range of users in making economic decisions". Given the above, the importance of financial reporting cannot be overemphasized. In such a way, SMEs require the use of these practices to use for different decision-making purposes, consequently, financial reporting practices help SMEs organizations to raise capital both domestic as well as overseas for their investment creation, promotion and diversification and based on financials, the public in large can analyze the performance of the organization as well as of its management [Atuilik & Salia, 2018].

There are many SMEs in Rathnapura Districts. Out of those, most of them are in very small and some are in a medium. The basic objective of the entrepreneur is to maintain their livelihood along with the contribution to the economic development according to their business performance. All of the SMEs use financial reporting practices in a level; good, fair, and poor. Some SMEs used financial reporting practices properly and they know them. But in Rathnapura District, more than 75% [CCI, 2017] SMEs are not in a position to use these practices well. These SMEs used these practices without having a good level of knowledge of financial management and reporting. The main reasons behind having such a poor environment are the lack of public accountability, lack of knowing the above-specified regulations, lack of mandatory audit requirements, and lack of resources. Therefore, the owners and managers of these SMEs should understand the role of financial reporting in the form of clear information requirements ensuring a proper justification for business transactions and operations. There is a significant negative impact of poor financial management and reporting practices on the growth and sustainability of SMEs [Uddin *et al.*, 2017]. Moreover, business decisions are required to be comprehensively supported with good quality financial information in a relevant, user friendly and promptly accessible manner. However, many owners or managers operate their business activities without any reporting or financial perspective and take much important investment, financing, operating and profit decisions without any proper financial analysis. On the same, most probably, SMEs fail to understand the actual financial status of their own business.

The accounting systems provide a source of information to owners and managers of small businesses operating in any industry for the use in the measurement of financial performance [Maseko & Manyani, 2011]. Further to McMahon & Holmes (1991) and Firer *et al.* (2004), financial management decisions include Investment decision (capital budgeting decision). Investment decision refers to the process of planning and managing a firm's long-term investments. Capital budgeting is used to evaluate whether investments in fixed assets such as new machinery, new plants, new products, and research development projects are worth pursuing. Capital budgeting techniques include non-discounted cash flow techniques (payback period and the accounting rate of return) and the discounted cash flow techniques (net present value, internal rate of return, profitability index, and discounted payback period). Besides, Oduware (2011) expressed that, financial management entails planning small businesses supply complete and relevant financial information needed to improve economic decisions made by entrepreneurs. To date, there have been limited researches on financial reporting practices by SMEs and even less is known about the users and uses of SME financial statements in the context of developing economies [Sutthirat, 2012, Sian & Roberts, 2006, Evans *et al.*, 2005]. Besides, in the debate on SME financial reporting presently occurring in various countries, there are arguments made on the lack of empirical evidence on the financial reporting needs of SMEs. This current study seeks to investigate the impact of financial reporting practices on the performance of SMEs in Rathnapura District, Sri Lanka. It is expected that the empirical findings of this study will be of interest to future researchers, field stakeholders and accounting standards setters in Sri Lanka, especially those who are considering simplifying financial reporting requirements for SMEs. Therefore, researchers selected the above-mentioned research topic to know the actual landscape of financial reporting practices on the performance of SMEs with special reference to Rathnapura District.

Theoretical Foundation

SMEs are defined in a variety of ways by various countries using such parameters as no of persons employed, amount of capital invested, amount of turnover or nature of the business SMEs (International Monetary Fund, 2018). Then, SMEs can be defined by the Department of Small Industries as an enterprise with fewer than 50 people and capital investment less than LKR. 05 million and/or an enterprise with less than LKR. 08 million investment and less than LKR. 50 million annual turnover (Export Development Board). Hence, a clear definition is needed to: provide concessionary financial facilities on a targeted basis and provide specific business development services. Therefore, the Department of Census & Statistics has started an "Economic Census" in 2013/14 with

Table 1: Definition of SMEs

Size/Sector	Criteria	Medium	Small	Micro
Manufacturing Sector	Annual Turnover	RsMn 251-750	RsMn 16-250	Less than RsMn 15
	No. of Employees	51- 300	Nov-50	Less than 10
Service Sector	Annual Turnover	RsMn 251-750	RsMn 16-250	Less than RsMn15
	No. of Employees	51-200	Nov-50	Less than 10

Source: [National Policy Framework SME, 2016]

a key objective to prepare a unique definition for Micro- Small, and Medium Enterprises in Sri Lanka. As the same, World Bank states that: if any enterprise has below 99 people, it can be defined as an SME. The term SME is used to denote micro, small and medium enterprises. Different countries use different definitions for SMEs based on their level of development. The commonly used yardsticks are total number of employees, annual turnover and total investment. In the Sri Lankan context, the SME policy framework defines SMEs based on the number of employees and annual turnover [National Policy Framework SME, 2016] as in table 1.

The category of Small and Medium-sized Enterprises (SMEs) is made up an enterprise, which employs less than 300 employees and which has an annual turnover not exceeding Rs.750 Mn. In this context, micro-enterprises are also read with SMEs for any policy related measures [National Policy Framework SME, 2016]. In terms of definition, both criteria are considered in defining SMEs. In the event of an enterprise, falling under more than one category, then the number of employees should be the deciding factor. The ceiling applies to individual enterprises only. Subsidiaries of holding companies shall not be considered as SMEs. However, in the event of turnover and the number of employees of the whole group is within the above limits this exclusion will not arise. The purpose of SME definition is to provide an instrument for the targeting of policy, provision of national statistics on SMEs, serve as the basis for directing the state support for SMEs and targeting a broader range of policy measures. This definition is revisited once in three years and amended where necessary based on the economic and business development in the country [National Policy Framework SME, 2016].

Financial Reporting Practices

Gitman (2007) defines financial management as the area of business management devoted to judicious use of capital and a careful selection of sources of capital to enable an organization to move in the direction of reaching its goals. This definition points to certain essential aspects of financial management namely prudent or rational use of capital resource and achieving the goal of the firm. According to Oduware (2011), financial management entails planning for the future of a business enterprise to ensure positive cash flow. Brinckmann *et al.* (2010) andMSG (2019) define financial management as managerial activities that concern the acquisition of financial resources and the assurance of their effective and efficient use. Financial management involves planning, organizing, directing and controlling the financial activities such as the procurement and the utilization of funds of the enterprise. According to Firer (2004), Firer *et al.* (2004), Gitman (2007) and Ampah & Jagongo (2015) financial management decisions include investment decision (capital budgeting decision). Investment decision refers to the process of planning and managing a firm's long-term investments. Capital budgeting is used to evaluate whether investments in fixed assets such as new machinery, new plants, new products, and research development projects are worth pursuing. Capital budgeting techniques include non-discounted cash flow techniques (payback period and the accounting rate of return) and the discounted cash flow techniques (net present value, internal rate of return, profitability index and discounted payback period). Working capital management involves managing the short-term assets and liabilities of a firm. Working capital management ensures that a firm has sufficient cash flow to meet its short-term debt obligations and operating expenses. Financial decision (capital structure) relates to the raising of finance from various sources depending on the type of source, the period of financing, cost of financing and the returns [Turyahebwa, *et al.*, 2013]. Capital structure refers to the way a company finances its assets through some combination of equity, debt, or hybrid securities. Dividend decision involves the decision concerning the net profit distribution (dividend payment to shareholders and retained earnings).

Holmes & Nicholls (1989) summarize that management accounting information is associated with success and failure in SMEs depending upon how they are produced and utilized in their companies. However, Horngren (1995) as cited by Tanvogswal and Pinvanichkul (n.d); Rathnasiri (2014) argues that cost accounting or management accounting concepts and techniques are neutral instruments. It is not the cause of poor management but managers of the firms may use primarily symptoms since it wisely or stupidly. Drury & Tayles (1995) 8 conclude that the same rules and procedures established for external reporting (financial accounting) are likely also to be applied to internal reporting (management accounting). Though external and internal reporting tend to employ the same rules, it does not mean that management accounting is subservient to financial accounting. The reason that most companies adopt the identical practices for both reporting systems is that firms prefer their internal profit to be reported consistently with external financial accounting requirements so that they will be comparable with outsiders' assessments of overall company performance. In other words, companies would like to ensure the internal accounting system does not have any conflicts with external financial accounting requirements. There have been many empirical studies conducted in other countries investigating the types of financial reports produced by SMEs, the frequency of their preparation, and their perceived usefulness for management purposes. Comprehensive reviews of this empirical evidence and the findings of comparable research conducted internationally, up to the early 1990s are provided by McMahon & Holmes (1991).

Financial Performance of SMEs

As explored by Firer *et al.* (2004), the goal of financial management is to maximize the wealth of the owners of the firm. The goal of the firm is to maximize its value to its shareholders. Value is represented by the market price of the company's common stock, which, in turn, is a reflection of the firm's investment, financing, and dividend decisions. The market price of a firm's stock represents the focal judgment of all market participants as to what the value is of the particular firm. It takes into account present and prospective future earnings per share, the timing, duration, and risk of these earnings, and any other factors that bear upon the market price of the stock. The market price serves as a performance index or report card of the firm's progress. Further, for Maseko & Manyani (2011), accounting systems provide a source of information to owners and managers of small businesses operating in any industry for use in the measurement of financial performance. It is crucial therefore that the accounting practices of small businesses supply complete and relevant financial information needed to improve economic decisions made by entrepreneurs. Ismail & Zin (2009) note that business strategy is one of the main components that contributes to the growth among small firms. Padachi (2010) points out that the main factors that contribute to the success or failure of small businesses are categorized as internal and external factors. The external factors include financing (such as the availability of attractive financing), economic conditions, competition, government regulations, technology and environmental factors. The internal factors are managerial skills, workforce and accounting systems.

Findings from studies done earlier and government reports on the state of affairs of small-scale enterprises reveal that the sector faces numerous problems and constraints that affect their performance. While much research has been done on the small business, little has been done specifically on financial and reporting analysis practices of SMEs in Sri Lanka. The overall problem, therefore, is that relatively little is known about the impact of financial reporting and analysis practices in the financial performance of the small and medium enterprises in Sri Lanka. The high rate of failure among small firms, due mainly to inefficient management underscores the need to develop sound managerial skills. The small businessman who learns how to collect, analyze and interpret information and how it is relevant to specific problems will increase his firm's chances for survival, growth and profitability [Yoo & Kim, 2015].

Empirical evidence on Financial Reporting Practices on performance

As per the constructive and rationalized studies, it was noted that the empirical evidence on financial reporting and analysis practices on performance could be identified. Thomas III & Evanson (1987) studied 398 small pharmacies (in Michigan, North Carolina, Nebraska, Rhode Island and Washington) to examine the extent to which financial ratios were used in a specific line of small retail business and tested for a relationship between use of financial ratios and business success. The study used regression analysis to examine the relationship between financial ratio usage and SMEs' profitability. However, they could not demonstrate any significant relationship between earnings-to-sales and the number of financial ratios used by the owner in operational decision-making. Also, D'Amboise & Gasse (1980) studied the utilization of formal management techniques in 25 small shoe manufacturers and 26 small plastic manufacturers in Quebec, Canada found that 88 percent of the businesses used a cost accounting system. Regarding accounting standards, DeThomas & Fredenberger (1985), in a survey of over 360 small enterprises in Georgia, found that the standards of financial record-keeping were very high. In addition to cheque and deposit receipts, around 92 percent of respondents had some form of record-keeping. Subsequently, to the use of financial information, Farhoodman & Hryck (1985) reported on the most important applications of computers, and it was found that accounting has been rated as the highest percentage. Similarly, Ministry of Industry and Commerce in Sri Lanka [National Policy Framework SME, 2016] interviewed 36 small independent retail owner-managers and found that 33 percent of the sample businesses used computerized accounting systems. Reviewing previous research results shows accounting and financial management applications dominated the use of computers in small and medium enterprises in North America in the 1980s and 1990s. In parallel to the study conducted by Cooley & Pullen (1979), cash management was seen as the process of planning and controlling cash flows. It consisted of three basic components: cash forecasting practices, cash surplus investment practices, and cash control practices. Cooley & Pullen (1979) examined cash management practices of 122 small businesses engaged in petroleum marketing and reported that 73 percent of respondents had experienced a cash surplus.

Furthermore, the previous studies done on inventory management practices, D'Amboise & Gasse (1980) studied the utilization of management techniques in small shoe and plastic manufacturing industries in Canada and found 64 percent of the shoe and 65.4 percent of plastic businesses employed formal inventory control systems. While Grablowsky & Rowell (1980) found that most of the respondents had above 30 percent of their capital invested in inventory, the general standard of inventory management was poor. Only six percent of businesses in their survey used a quantitative technique such as economic order quantity for optimizing inventory and 54 percent had systems which were unable to provide information on inventory turnover, reorder points, ordering costs, or carrying costs. Similarly, it was emphasized that Grablowsky (1983) compared methods used by a sample of 94 small enterprises with those used by large enterprises and found that large enterprises used methods to determine inventory levels far more than small enterprises.

Findings from studies done earlier and government reports on the state of affairs of small-scale enterprises reveal that the sector faces numerous problems and constraints that affect their performance. While much research has been done on the small business, little has been done specifically on financial and reporting analysis practices of SMEs in Sri Lanka. The overall problem, therefore, is that relatively little is known about the impact of financial reporting and analysis practices in the financial performance of the small and medium enterprises in Sri Lanka. The high rate of failure among small firms, due mainly to inefficient management underscores the need to develop sound managerial skills. The small businessman who learns how to collect, analyze and interpret information and how it is relevant to specific problems will increase his firm's chances for survival, growth, and profitability [Balagobei, 2020].

CBSL (2017) stated that SMEs play an important role in both developed and developing countries. Accordingly, SMEs contribute to the growth of the economy in many ways such as employment generation, new venture development and opening up new avenues for the growth in the economy. However, it was found that there are many failures of SMEs in Sri Lanka such as inadequate capital, inadequate institutional credit facilities and proper standardized reporting, use of outdated technology, improper accounting techniques, inadequate sales promotion competencies and inattentiveness of small business by the Sri Lankan SME sector. Further financing has become a big challenge, even though the state owned banks and other development institutions have taken various measures to assist SMEs in providing finances over the period [NEDA, 2011]. Those obstacles have resulted from inefficient business administration and, lack of experience in some important business functions. Especially accounting and finance. The high rate of failure among small firms, mainly due to inefficient management underscores the need to develop sound management skills. The small businessperson who learns how to collect by analyzing and interpreting information on how it's relevant to specific problems will increase his firm's chances for survival, growth and profitability [Yoo & Kim, 2015].

As defined by MSG (2019), financial management means planning, organizing, directing and controlling the financial activities such as procurement and utilization of funds of the enterprise. It means applying general management principles to the financial resources of the enterprise. This definition points to certain essential aspects of financial management namely prudent or rational use of capital resource and achieving the goal of the firm as well as financial management entails planning for the future of a business enterprise to ensure positive cash flow. Brinckmann *et al.* (2010) and MSG (2019) define financial management as managerial activities that concern the acquisition of financial resources and the assurance of their effective and efficient use. Financial management involves planning, organizing, directing and controlling the financial activities such as the procurement and the utilization of funds of the enterprise. According to Firer *et al.* (2004) and Gitman (2007), financial management decisions include investment decisions (capital budgeting decision). Investment decision refers to the process of planning and managing a firm's long-term investments. Capital budgeting is used to evaluate whether investments in fixed assets such as new machinery, new plants, new products, and research development projects are worth pursuing. Capital budgeting techniques include non-discounted cash flow techniques (payback period and the accounting rate of return) and the discounted cash flow techniques (net present value, internal rate of return, profitability index and discounted payback period). Working capital management involves managing the short-term assets and liabilities of a firm. Working capital management ensures that a firm has sufficient cash flow to meet its short-term debt obligations and operating expenses. Financial decision (capital structure) relates to the raising of finance from various sources depending on the type of source, a period of financing, cost of financing and the returns. Capital structure refers to the way a company finances its assets through some combination of equity, debt, or hybrid securities. Dividend decision involves the decision concerning the net profit distribution (dividend payment to shareholders and retained earnings).

In a research on the insight on the adaptation of different financial reporting practices of SME's in Sri Lanka conducted by Jagoda *et al.* (n.d.), the findings revealed that there is a significant relationship between financial reporting practices and financial performance of the small and medium-sized enterprise in Western province, Sri Lanka. Further, it was proved that the problems related to finance have been considered as the critical and foremost reasons for increasing the failure rate of SMEs. The weak financial base may depend on other problems like upgrading of technology, expansion of production capacity, production efficiency, lack of access to bank facilities, etc. On the other hand, many studies prove the fact that sound financial reporting practices not only control the financial position but also significantly contribute to improving and increasing the profitability of SME's government and non-governmental organizations that provide lending to the SME's. All these need to be structured in a better way for rating the financial risks that are faced by the SME's.

Methods

This study is conducted through a descriptive research design applying a quantitative method. In this instance, the important consideration is to assess factor- oriented research or study by using identified characteristics or variables inter-alia. Also. It is important to note that descriptive research is essential to identify and educate problem situations of any research or

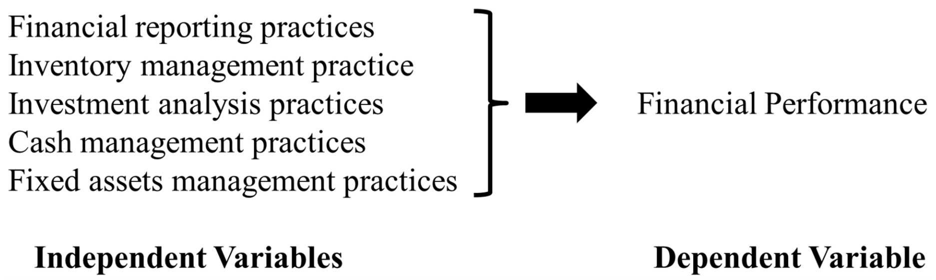

Figure 1: Conceptual model

study. Primary data was used in the study by distributing a structured questionnaire to SMEs consisting 40 questions according to Likert scale (1 to 5 - one - Strongly Disagree, two Disagree, three Neutral, four Agree, five - Strongly Agree) as operationalized. Besides, the reading and other tools were used to collect study aids from different sources like annual reports, textbooks, internet, newspapers, magazine, and journals. The population includes 300 SMEs registered under the chamber of commerce in Rathnapura. The sample was selected according to the definition of the Department of Small Industries (DSI), the entire group of SMEs who does not exceed the capital investment of Rs.5 million and employees should be fewer than Rs.50 million, for this study, the researcher selected 60 SMEs by using the simple random sample method. The SMEs running the business were selected in Rathnapura, Balangoda, and Weligepola secretariat divisions in the Rathnapura District.

To test the hypotheses, questionnaires were distributed among SMEs and collected 40 questionnaires along with the discussions on their financial reporting practices. The structured questionnaire consists of 40 questions which is covered all independent variables and dependent variables, as well as the questionnaire consists of three parts as personal information, information on their level of financial reporting and analysis practices and their financial performance.

The research has selected five factors as independent variables which affect the financial performance of SMEs. These are financial reporting practices, investment analysis practices, inventory analysis practices, and cash management practices and fixed assets management practices. First, financial reporting is very important and most voluble and considerable terms when conducting any kind of business. Because financial reporting is essential to gain success in the business, and because every large-scale organization prepares and present financial statements after the year ended it is compulsory for information users. Because information uses are related parties in a particular organization they want to know about the organization's performance, expenses, profit and other things. Some SMEs are not keeping proper financial reporting methods .Most SMEs are kept in a single entry system to record their transactions. Then it will affect their financial performance indirectly. Without financial reporting they cannot manage their properties. Then financial reporting is a very important factor for growth in the long-term. Second, investment decisions refer to the process of planning and managing the firm's long- term investments. Sometimes SMEs invest in fixed assets such as new machinery, new plants, and new products. Most SMEs invest their money in micro-finance institutions and short-term investment projects. Most SMEs think about the investment period, return on investment and risk of investment. Third, inventory analysis practices are important to the firms as the inventory is the main resource of manufacturing firms. Then they must properly manage their inventories. Most SMEs use physical safeguards for inventory against the theft. Also, firms periodically count their inventories. Some firms use computer-assisted software in recording inventory, and most small businesses determine inventory levels are based on the owner's experience. Some SMEs use historical data to determine inventory levels. Fourth, the purpose of the cash management practices is to ensure positive cash flows. Moreover, cash management activities are concerned about the acquisition of financial resources and the assurance of their effective and efficient use. Cash management practices involve planning, organizing, directing and controlling the financial activities such as the procurement and the utilization of funds of the enterprise. Because cash is the main dependent factor of any organization. Therefore, SMEs also want to keep good attention to their cash management practices. Fifth, every organization should acquire and manage their fixed assets for the long term business survival. Every firm must have a proper method for purchase and utilization in fixed assets.

Table 2: Age of the SMEs

Age	No. of SMEs
6-May	32
10-Jun	3
15-Nov	2
16- 20	5
Above 20	18

Source: Collected data from the survey

Table 3: Education level of SMEs

Education level of the owner	No. of SMEs
Primary	4
Secondary	9
Tertiary	6
University	11

Source: Collected data from the survey

Dependent variable of this study is the financial performance of the SMEs. The financial measurement of performance is the traditional and most commonly used tool as a measure of an organization's performance. Financial measures focus on profitability, the market value of the firm, return on assets, investment and equity, liquidity and various other ratios. According to this study, performance was measured by specially designed questions.

Based on the above variables the researcher developed a conceptual framework in accordance to the research problem as shown in figure 1.

After designing the above framework, the research hypotheses were formulated to test the impact of financial reporting practices on the financial performance of SMEs in Rathnapura District.

H$_0$ = There is no impact on financial reporting and analysis practices on financial performance of SMEs in Rathnapura District, Sri Lanka.

H$_1$ = There is an impact on financial reporting and analysis practices on financial performance of SMEs in Rathnapura District, Sri Lanka.

The objective of this study is to identify the impact of financial reporting and analysis practices on the financial performance of SMEs. The researcher used multiple regression analysis methods. The following regression model was used in this study.

$$Y = \beta_0 + \beta_1 \cdot FR + \beta_2 \cdot IAP + \beta_3 \cdot INAP + \beta_4 \cdot CMP + \beta_5 \cdot FAP + \epsilon$$

where Y = Financial Performance, β_0 = constant, β_1, β_2, β_3, β_4, β_5 are the coefficients of each independent variable and ϵ =error term.

Reliability coefficient as Cronbach's Alpha coefficient shows average correlation. Among the items that include under a variable, this Alpha value can range from 0 to 1. Sekaran & Bougie (2009) indicated that if the Cronbach's value is less than 0.6 it is considered to be poor, those in the range 0.7 acceptable and those over 0.8 good. Reliability refers to the degree of consistency in measurement and the lack of error. By using the methods as explained in this section the performance of the results and discussion on the research findings will be provided in the next section.

Results and Discussion

The objective of this study is to find the impact of financial reporting and analysis practices on financial performance of small and medium enterprises in Rathnapura District in Sri Lanka. To achieve this objective, the study focused mainly consists of sixty (60) SMEs. The study constitutes regression results in determining the relationship between financial reporting and analysis practices on the financial performance of SMEs in Rathnapura District, Sri Lanka by carrying out a correlation and regression model using SPSS software to ascertain the impact of the independent variables on the dependent variable. All firms responded to the questionnaire and the result of the survey concluded to analyze and find the relationship and impact of the financial reporting and analysis practices and financial performances of SMEs in Sri Lanka. Data was gathered by using questionnaires while selecting the whole population of the SMEs in Rathnapura District. According to the demographic data collected, those were presented as follows.

The age categories and number of SMEs under each category are shown in the table 2. It explains the age of the SMEs in Rathnapura indicating that sampled 53% of SMEs (32 no) are in the years 1-5 level and balanced (46%) SMEs are in the level beyond that.

Levels of education and number of SMEs under each category are shown in table 3. It describes the education levels of the SMEs in Rathnapura. In this case, twenty-nine SMEs are reluctant to give their educational level even though they operate their businesses well. Out of balanced thirty 31 SMEs, twelve (12) firms are well- educated with university degrees and functioning their businesses well. Eleven (11) SMEs completed their education up to primary and education levels. Six (06) SMEs represent the tertiary education level completing vocational qualifications and starting businesses. However, all sampled SMEs are in successful business operations

Table 4: Form of Business Organization

Form of Buss. Organization	No of SMEs
Sole proprietor	48
Partnership	12

Source: Collected data from the survey

Table 5: Account and financial related knowledge

Knowledge of accounts and finances	No of SMEs
Yes	49
No	11

Source: Collected data from the survey

The form of the business and number of SMEs, which are falling under each category, can be shown as in table 4, which depicts the propriety of sampled SMEs indicating that forty-eight (48) no of SMEs are sole proprietors and twelve (12) no of SMEs' having partnership business.

Table 5 shows the number of SMEs whose owner or manager has financial related knowledge or not. Most of SMEs (49) has accounting and financial related knowledge and the balanced (11 no) SMEs do not have any accounting and financial related knowledge.

To measure the reliability of items of the questionnaire, Cranach's Alpha Coefficient was used. Based on the result of this test, it was noted that all the values were valuated over 0.7 indicating the confirmation of reliability on variables and its measures of the questionnaire.

After testing the reliability of responses on variables, the Cronbach's Alpha values of each independent variable with the dependent variable were received (table 6). All independent variables (financial reporting, investment analysis practices, inventory analysis practices, and cash management practices) have shown in the required level of acceptance that all the values being over 0.7. Therefore, the reliability of various parts of questionnaires is confirmed.

Table 7 shows the values of the range, minimum, maximum, mean, and standard deviation of independent and dependent variables. In the process of comparing the independent variables (financial performance) as; financial reporting, inventory analysis practices, cash management practices and fixed assets management practices all variables have high mean values in a range of more than 3, except the mean value 2.97 of investment management practices. However, IAP is also closer to mean value 3 and it can be accepted. According to table 7, all independent and dependent values have low maximum value in a range of 1 to 2 and financial performance has low mean value too than other variables. The maximum and minimum values for each measure indicate that all variables vary considerably among each other. In aggregate, all the variables have recorded results closer to the highest among comparing all descriptive values so that the factors affecting financial reporting and analysis practices are highly effected by the financial performance of SMEs in Rathnapura District.

In this study, a multiple regression analysis was conducted to test the influence among predictor variables. The research used the statistical package for social sciences (SPSS V 20) to code, enter and compute the measurements of the multiple regressions. Likert scale was used to determine the relationship between financial reporting and analysis practices and the financial performance

Table 6: Reliability Test

Variable	Cronbach's Alpha	No. of Items
Financial Performance of SME's	0.838	6
Financial Reporting	0.771	6
Investment Analysis Practices	0.842	6
Inventory Analysis Practices	0.874	6
Cash Management Practices	0.779	6
Fixed Assets Management Practices	0.718	4

Source: Researchers data analysis through SPSS

Table 7: Data Analysis Results under Descriptive Statistics on Financial Performance

	N	Minimum	Maximum	Mean	Std. Deviation
FR	60	1	5	3	0.974
IAP	60	1	5	2.97	1.067
INAP	60	1	5	3.04	1.106
CMP	60	1	5	3.02	0.983
FAP	60	1	5	3.05	1.124
FP	60	1	5	3.01	1.043
Valid N (list wise)	60				

Source: Researchers' data analysis through SPSS

Table 8: Model Summary

Model	1
R	0.966
R^2	0.933
Adjusted R^2	0.927
Std. Error of the Estimate	0.278

a. predictors:(constant). FAP, CMP, FR, IAP, INAP
Source: Researchers data analysis through SPSS

of the small and medium enterprises in the Rathnapura District. The Likert questions were quantified through SPSS and run for the multiple regression analysis on the Impact of financial reporting and analysis practices and financial performance of small and medium enterprises in Rathnapura district.

Adjusted R^2 is called the coefficient of determination and it shows how the change in the independent variable results to changes in the dependent variable. From the data, the value of R^2 is 0.933. This implies that there was a variation of 93% (Approx.) of the financial performance of SMEs dues to changes in financial reporting, investment analysis practices, inventory analysis practices, cash management practices and fixed assets management practices, at the 93% confidence interval (table 8). The remaining 7% (Approx.) of profitability variance explained by other factors have not been depicted in the model.

The R square value of the model is 0.933. It indicates that 93.3% of variation an impact on financial performance is explained by the five independent variables. Variance Inflation Factor (VIF) is calculated to test the multi-collinearity of the independent variables in the model so that all VIF values are well below 10 confirming that there are no multicollinearity issues in the regression model. Based on the significance of regression coefficients, only the variables financial reporting, investment analysis factors and fixed assets management practices have been accepted from the model as the highly significant in depicting the effect of financial performance. This indicates that higher the level of financial reporting, investment analysis practices and fixed assets management practices the higher the effect for financial performance. The result shows that financial reporting, investment analysis factors, and fixed assets management practices contribute most to the overall financial performance which should be considered by the financial managers for their decision-making. From the above regression model, it revealed that holding financial reporting, financial analysis, financial management

Table 9: ANOVA F test

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	57.261	4	11.452	147.864	0.000
Residual	4.105	54	0.077		
Total	61.366	58			

a. Dependent variable: FP
Predictors (constantan) CMP, FR, INAP, IAP
Source: Researchers data analysis through SPSS

Table 10: Summary of Regression Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients			Co linearity Statics	
	B	Std. Error	Beta	t	Sig.	Tolerance	VIF
1 Constant	-0.04	0.133		-0.304	0.762		
FR	0.569	0.106	0.533	5.391	0	0.129	7.735
IAP	0.27	0.093	0.277	2.907	0.005	0.139	7.206
INAP	-0.111	0.095	-0.12	-1.174	0.246	0.121	8.26
CMP	-0.015	0.088	-0.14	-0.167	0.868	0.18	5.542
FAP	0.302	0.075	0.325	4.039	0	0.195	5.137

Source: Researchers data analysis through SPSS

and management accounting to constant zero financial performance would stand at- 0.040. A unit increase in financial reporting would lead to increase in financial performance by 0.569 units, a unit increase in investment analysis would lead to increase in the financial performance of SMEs by 0.270 units; and a unit increase in fixed assets management practices would lead to increase in the financial performance of SMEs by a factor of 0.302.

$$Y = \beta_0 + \beta_1 \cdot X_1 + \beta_2 \cdot X_2 + \beta_3 \cdot X_3 + \beta_4 \cdot X_4 + \beta_5 \cdot X_5 + \epsilon$$

$$FP = -0.040 + 0.569X_1 + 0.270X_2 - 0.111X_3 - 0.015X_4 + 0.302X_5 + \epsilon$$

Among the above five independent variables, financial reporting is more significantly influencing financial performance than other independent variables. The coefficient value of financial reporting is 0.569 and it explains that when the financial reporting increased by 1% financial performance will be increased by 0.569% assuming that other independent variables are constant and it is statistically significant at 5% level. Second, the variable, fixed assets management practices are then significantly influencing financial performance than the other three independent variables as investment management practices, inventory analysis practices and cash management practices. The coefficient value of fixed assets management practices has 0.302 and it explains that when the fixed assets management practices are increased by 1% financial performance will be increased by 0.302% assuming that other independent variables are constant and it is statistically significant at 5% level. Third, the variable investment analysis practices are then significantly influencing financial performance than the other two independent variables as inventory analysis practices and cash management practices. The coefficient value of investment analysis practices has 0.270 explains that when the investment analysis practices are increased by 1%, financial performance will be increased by 0.270% assuming that other independent variables are constant and it is statistically significant at 5% level. Fourth variable, cash management practices is then negatively influencing financial performance than inventory analysis practices. The coefficient value of cash management practices remain at -0.015 and it explains that when the cash management practices are increased by 1% financial performance will be decreased by 0.015% assuming that other independent variables are constant and it is statistically insignificant. Fifth variable, inventory analysis practices are then negatively influencing financial performance than inventory analysis practices. The coefficient value of cash management practices is -0.111 and it was explained that when the inventory analysis practices are increased by 1% financial performance will be decreased by -0.111% assuming that other independent variables are constant and it is statistically insignificant.

According to the hypotheses formulated in the section, hypothesis H1 is accepted since the p-value of regression coefficients the three variables; financial reporting, fixed assets management practices and investment analysis practices are less than the 0.05 level (60% of total variables and 93% of the impact is derived for the financial performance). On the other hand, the null hypothesis H0 is rejected. In this section the researcher analyzed the findings from the data collected to achieve the research objectives and prove the hypothesis to find out the impact of financial reporting and analysis practices to the financial performance by using descriptive statistics and regression analysis. According to those analyses, the researcher found a significant impact between financial reporting and analysis practices which are affecting the financial performance.

Conclusion

This study is empirical in its nature that evaluates the financial reporting practices in SMEs and investigates the impact of the selected function or methods of financial reporting on SMEs of Rathnapura District. Most SMEs follow indirect financial reporting. The study reveals a lack of financial management knowledge of the majority of SMEs in considering the practicing of the operation. To achieve this task questionnaires comprising various aspects of the financial reporting system of SMEs were administered at the data collection phase, the hypothesis was formulated and tested where the alternative hypothesis was selected. Findings show that an effective financial reporting system in SMEs has a reflective impact on financial performances. Thus financial reporting systems show the books, records, and files and related supporting documents resulting from the application of the financial reporting process of the studied enterprises. So, this study examines the profiles of financial information usage in SMEs in Rathnapura Districts in Sri Lanka. The study findings revealed that there are some mentionable observations regarding the use of financial reports. This study revealed that the level of awareness on the importance of financial management is still to apply since the financial reporting system very low in SMEs. Most of the owners and managers (In Rathnapura District, more than 75% SMEs) are not in a position to use these practices correctly. These SMEs used such practices without having a low level of knowledge of financial management and reporting). The main reasons behind having such a poor environment are the lack of public accountability, lack of knowing the above-specified regulations, lack of mandatory audit requirements, and lack of resources. They are not aware of the importance of keeping a sound financial report and supporting documents. These reports must be prepared and used in an orderly manner and complete along with all the important information regarding their business operations. According to the multiple regression results, the value of R^2 is 0.933 and it implies that there was a variation of 93% (Approx.) of the financial performance of SMEs due to the changes in the financial reporting practices, investment analysis practices, inventory analysis practices, cash management practices and fixed assets management practices. The remaining 7% (Approx.) of financial performance variance was explained by other factors that have not been depicted in the model. It means that the use of these practices is highly significant to maintain a sound financial reporting system that affects optimal decision making for obtaining better financial performance of the SMEs in the Rathnapura District. In this juncture, financial reporting practices, investment analysis practices, and fixed asset management practices are highly supported to the achievement of better financial performance than that of the practices of inventory management practices and cash management practices. Therefore, SMEs are strongly requested to express their opinion of what could be done to improve the financial reporting practices for the fulfillment of their decision-making requirements as well as all other on-time organizational and statutory requirements of SMEs. A list of some suggestions was presented to respondents. Based on the findings, it is observed that the respondents agree that educating and encouraging managers and owners on the need to keep financial reports is the best solution. This is in agreement with the fact that most of the respondents who do not keep the records believe that it is not useful to keep financial reports and documents, organize training for managers and owners, and hire consultants for SMEs for financial statement analysis. Make use of financial reports and reports are to be made

Table 11: Hypotheses Testing

	Hypotheses	Coefficient	P value	Decision criteria	Supported/ Not supported
H1a	There is significant relationship between FR and FP	0.569	0	P<0.05	Supported
H1b	There is significant relationship between IAP and FP	0.27	0.005	P<0.05	Supported
H1c	There is significant relationship between INAP and FP	-0.111	0.246	P>0.05	Not supported
H1d	There is significant relationship between CMP and FP	-0.015	0.868	P>0.05	Not supported
H1e	There is significant relationship between FAP and FP	0.302	0	P<0.05	Supported

Source: Researchers data analysis through SPSS

mandatory in all aspects of decision making in the areas of investment, financial, operating and dividend decisions. Moreover, the study suggested that offering free record keeping and advisory services and user-friendly management information and regulatory guidelines are to be formulated with the stakeholders' involvement under the governing authorities of the government and professional bodies are to be concentrated as a must. Finally, authorities of the government, promotional and infrastructural and professional bodies should exactly motivate managers/owners to adopt standardized financial management reporting with other managerial aspects, strengthen monitoring and supervision, inform managers/owners on the need to keep record-keeping and reporting on-time and to provide more potential training center and courses for SMEs.

Finally, this research, following its research gap, was focused only on the financial reporting practices of small and medium entrepreneurs in a small area in Sri Lanka. Therefore, an extension of this study or other related research should be conducted for increasing the avenues in this particular field. Such research should keep the following additional themes in mind. The future researcher may spend more time visiting and collecting data from the highest sample of SMEs. The future researchers can increase the size of the sample in the study and find more variables than this research to measure the financial reporting and analysis practices.

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