

# FACTORS AFFECTING APPLICATION OF ACCOUNTING STANDARDS IN ĐÀ NẴNG-BASED SMALL AND MEDIUM ENTERPRISES

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*Although Vietnam's accounting standards were first promulgated in 2001, only a few researches on the application of these standards and influential factors were carried out. This paper aims at examining such influential factors in small and medium enterprises (SMEs) in Đà Nẵng. Results of the research show that only a small proportion of accounting standards are implemented by Đà Nẵng SMEs. Regression analysis also shows that competence of accountants is one of important factors that affect the application of these standards. Closer investigation by tax agencies and requirement for audited financial statements may produce favorable impacts on the application of accounting standards among Đà Nẵng SMEs.*

Keywords: Accounting standards, SMEs, application

## 1. Introduction

SMEs make an important contribution to the Vietnam's economic growth. In their development, providing good accounting services is one of effective managerial tools for SMEs owners and a sound basis for the public control over SME operations, leading to transparency of financial information, a favorable condition for their participation in the capital market.

Accounting rules for SMEs were first issued in 1996 and they have been adjusted many times since then (the most recent one was Decision 48 made in September 2006) to cope with changes in the economic life. The Decision is based on Vietnam's accounting standards introduced in 2001 and applied exclusively to SMEs. In spite of such important changes in legal basis, the

number of researches on factors affecting the application of accounting standards among SMEs is very small. Many of them are only limited to organization of accounting departments or characteristics of these standards (Hà Thị Ngọc Hà, 2006; Ngô Đức Đoàn, 2006; Mai Thị Hoàng Minh, 2007; and Nguyễn Hoản, 2007), and *none of them offers precise appraisals of application of accounting standards*.

On the contrary, this aspect has been carefully examined by foreign authors, and most influential factors are found related to firm characteristics, such as size (Chow and Wong-Boren, 1987; Cooke, 1991); profitability (Belkaoui and Kahl, 1978; Singhvi and Desai, 1971; Wallace and Naser, 1995); owner's perception (Page, 1984; Collis and Jarvis, 2000); educational

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background (Doupnik and Salter 1995); and structure of debt (Sekely and Collins, 1988). These researches, however, are mostly conducted in developed countries, or economies where Anglo-Saxon accounting model are applied. This allows more rooms for researches on ways of accounting standard application in various countries.

The question for us now is, what are factors affecting the application of accounting standards in Vietnam? Answers to this question based on data from various provinces may provide a closer view on application of accounting standards and help perfect such standards in the background of internationally economic integration. The paper presents a survey SMEs in Đà Nẵng, a center in Central Vietnam Key Economic Zone where conditions are favorable for estimating the application of accounting standards in SMEs during the economic reform.

## 2. Research design

Numerous studies of factors affecting the application of accounting standards have been conducted. This paper is based on approaches taken by previous researches, and variables are selected with regard to characteristic conditions in Vietnam.

- Size of enterprise: Firm size is considered as a factor that affects greatly the application of accounting standards by many researchers, such as Chow and Wong-Boren (1987) and Cooke (1989, 1991), etc. Their researches show that the bigger the firm size, the more complicated its operations. And as a result, the application of accounting standards in such firms is better.

- Profitability: Researchers are divided on effects of this factor. Belkaoui and Kahl (1978), Singhvi and Desai (1971), and Wallace and Naser (1995) find that firms with high profitability tend to expand their territory and seek for new sources of finance. For these firms, the application of accounting standards is a precondition for ensuring that information disclosed by financial statements are honest and exact enough to persuade potential investors.

Dumontier (1998) and Inchausti (1997), however, maintain that convincing evidence of this argument is still lacking.

- Capital structure: This structure expresses proportion of various sources of finance employed by a firm. Studies by Zarzeski (1996) and Collins (1988) show that firms with small loans do not pay much attention to accounting standards because they do not have the need to share business information with partners. Regarding Đà Nẵng SMEs, we find that the bigger the bank loans, the better the application of accounting standards.

- Auditor's impacts: Al-Baskeki (1995) argues that auditing firm affects considerably the choice of accounting standards, especially international ones. The fact that a major auditing company is hired implies that the audited enterprise paid much attention to the application of international accounting standards. Comparing this fact with realities in Vietnam suggests that the application of accounting standards may be better in SMEs whose financial statements are audited. In Vietnam, however, SMEs are not required to have their financial statements audited. This implies that compliance with accounting standards in SMEs is very poor. Two dummy variables are used for measuring this factor.

If  $D1 = 1$ : financial statement of the enterprise is checked by tax agency.

If  $D2 = 1$ : financial statement of the enterprise is audited.

If  $D1 = 0$  and  $D2 = 0$ : financial statement of the enterprise is not checked or audited.

- Educational background: Researches in many countries show that accountants who are competent and well-trained have better ability to apply accounting standards (Gernon, Meek, & Mueller, 1987) because knowledge provided by training courses help them get better perception of accounting tasks and application of accounting standards.

- Owner's perception: Accounting is considered as a tool for monitoring and supervising operations and running the enterprise effectively. In many cases, however, it is only treated as a

tool for making tax declaration, and its role in business management is ignored. In this aspect, perception of enterprise owner will affect greatly the application of accounting standards.

Factor analysis is conducted to turn 15 attributes into four factors representing educational background and owner's perception.

Factor 1, "Accountant's competence," comprises such attributes as "Use of knowledge from post-graduation training," "Use of knowledge from college," "Even level of accountants' competence," and "Working experience."

Factor 2 comprises "Relying on guidelines on each accounting standard," "Regulations about accounting records," "Relying on original accounting standards," and "Adapting standards for big enterprises for SMEs." These attributes resulting from interviews with accountants show that the habit of using subordinate legislations affects the application of accounting standards. This factor is called "Practical guidelines"

Factor 3 is related to roles of trade associations, such as "Auditors' advices," "Advices from tax officials" and "Advices from fellow accountants," and named "Advices from business community."

Factor 4 refers to owners' perception of accountant's role and comprises two attributes, "Requirements from enterprise owner" and "Owner's interest in accounting job."

## 2. Methodology

A survey of 283 enterprises in various districts of Đà Nẵng is conducted to build a model of factors affecting the application of accounting standards among SMEs. Surveyed persons are chief accountants or employees in charge of accounting services. The surveyed is conducted by Đà Nẵng Institute of Socioeconomic Development with a questionnaire that focuses on:

- Standards applied in the enterprise
- Accountant's perception of the application of accounting standards

Besides the aforementioned independent variables, dependent ones to be measured are

from the list of accounting standards for SMEs set forth by Decision 48. This approach has been taken by several researchers, such as Cooke (1989), and Donna & Stephanie (2000).

$$\text{Proportion of standards applied by Enterprise i} = \frac{\text{Number of standards applied by Enterprise i}}{\text{Number of standards for SMEs}}$$

In addition to the above measurement, the "Proportion of financial statement made" value is used for estimating the application of standards. This is a relative scale because financial statement is usually considered as a final product of accounting process that presents ways of applying accounting standards. This proportion is defined as follows:

$$\text{Proportion of financial statements made by Enterprise i} = \frac{\text{Number of financial statements made by Enterprise i}}{\text{Number of required financial statements}}$$

## 3. Research results

Table 1 describes the application of accounting standards by Đà Nẵng SMEs. Analyses show that the most employed standards are closely related to SME daily operations, such as sale/purchase of goods/services, tangible fixed assets, corporate income tax, and presentation of financial statement. Particularly, the most applied is the General Standard that reflects basic accounting principles in measurement and presentation as an important benchmark for accounting job. Of standards whose applying rate is lower, the "Borrowing Costs" is applied by some 50% of surveyed SMEs. This means that many SMEs use bank loans to finance their businesses. Lower applying rates of certain standards are understandable because most Đà Nẵng SMEs have small sizes and working capital, and they therefore rarely engage in other businesses, such as import, export, and

**Table 1: Application of accounting standards among Đà Nẵng SMEs**

Standard	Applying rate per standard	Applying rate by industry			
		Manufacturing	Trading	Service	Mixed business
<b>A. Group of standards with average (and higher) applying rates</b>					
1. Presentation of Financial Statements	71%	37.5%	60.7%	68.6%	81.6%
2. Tangible Fixed Assets	70%	50%	52.5%	68.6%	81%
3. Corporate Income Tax	68.8%	37.5%	65.6%	70.6%	74.2%
4. Revenues and other Incomes	68.2%	41.7%	60.7%	64.7%	76.9%
5. Inventories	67.8%	66.7%	65.6%	54.9%	73.5%
<b>B. Group of standards with low applying rates</b>					
6. Borrowing Costs	44.2%	50%	41%	49%	42.9%
7. Events After the Balance Sheet Date	42%	20.8%	24.6%	42.2%	53.1%
8. Cash Flow Statements	41%	66.7%	37.7%	62.7%	47.6%
9. Changes in Accounting Policies, Accounting Estimates and Errors	35.7%	33.3%	24.6%	33.3%	41.5%
<b>C. Group of standards with very low applying rates</b>					
10. Intangible Assets	22.3%	25%	14.8%	29.4%	22.4%
11. Leases	18.4%	25%	13.1%	23.5%	17.2%
12. Financial Reporting of Interests in Joint Ventures	12%	8.3%	9.8%	11.8%	13.6%
13. Effects of Changes in Foreign Exchange Rates	9.9%	-	13.1%	13.7%	8.8%
14. Accounting for Investments in Associates	9.5%	16.7%	6.6%	13.7%	8.2%
15. Construction Contracts	8.5%	12.5%	-	-	14.3%
16. Investment Property	7.1%	16.7%	3.3%	-	9.5%
17. Related Parties Disclosures	6.7%	4.2%	4.9%	9.8%	6.8%
18. Provision, Contingent assets, Contingent Liabilities	6.4%	4.2%	3.3%	9.8%	6.8%
<b>D. Average applying rate</b>	<b>45.5%</b>	<b>41.7%</b>	<b>39.8%</b>	<b>45.5%</b>	<b>47.9%</b>

investment in real estates that require larger sums of capital or sources of foreign exchange.

Process of developing the model of influential factors comprises two steps. In Step 1, all related variables are analyzed. In Step 2, however, financial variables are rejected because of doubts about reliability of financial data. Results of the 2-step process can clarify factors affecting the application of accounting standards among SMEs. Results of regression analysis by Enter method are presented in tables 2 and 3.

Examining the proportion of financial statements made by SMEs shows that the regression model is statistically significant at 1%. Factors that really affect the amount of financial statements completed in both experimental cases are "Accountant's competence" and "Impacts of inspection and auditing." The explanatory power of the model, however, only stays at a 17% level. In other words, this research fails to mention some other influential factors.

**Table 2: Analysis results with all variables**

	Proportion of financial statement made			Proportion of standards applied		
	Stan. coeff	t-stat	Sig.	Stan. coeff	t-stat	Sig.
(Constant)		4.764	.000		-.461	.646
Accountant's competence	.404	3.675	.000	.081	.640	.525
Practical guidelines	.125	1.141	.258	.068	.553	.582
Advices from business community	-.237	-2.050	.044	.100	.793	.431
Owner's perception	.093	.865	.390	-.131	-1.064	.291
Tax (D1)	.201	1.681	.097	.065	.503	.617
Auditing (D2)	.346	2.504	.015	.075	.511	.611
Log (assets) – Enterprise size	.124	.894	.374	.376	2.445	.017

Log (debt ratio) – Debt structure	-.096	-.847	.400	.180	1.445	.153
Log (ROS) – Profitability	-.847	-1.663	.101	-.020	-.146	.884
Adj. R-square			.173			.084
F-stat			2.854			1.733
Significance			.006			.100

**Table 3: Analysis results after elimination of financial variables**

	Proportion of financial statement made			Proportion of standards applied			
	Stan. coeff	t-stat	Sig.	Stan. coeff	t-stat	Sig.	
(Constant)			19.46	.000		8.484	.000
Accountant's competence	.195	2.969	.003	.068	1.010	.314	
Practical guidelines	.122	1.772	.078	.112	1.609	.109	
Advices from business community	-.073	1.041	.299	.294	4.213	.000	
Owner's perception	.054	.816	.416	.132	1.969	.050	
Tax (D1)	.205	2.962	.003	.101	1.446	.150	
Auditing (D2)	.351	4.801	.000	.035	.483	.629	
Adj. R-square			.176			.126	
F-stat			7.834			5.693	
Significance			.000			.000	

Regarding the proportion of accounting standards applied, analysis results show that the

model has no statistical significance when all variables are included. After eliminating variables measuring financial data, such as profitability, enterprise size, and level of debt use, however, the model is statistically significant at 1%. The application of accounting standards has a positive relationship with "Advices from business community" and "Owner's perception."

These results reveal the following problems:

"Accountant's competence" has a positive relationship with Proportion of financial statements made and Proportion of accounting standards applied in both analyzing steps. However, it is only statistically significant in the model of Proportion of financial statements made. This result implies that accountant's competence is important to the annual making of financial statement. Accountant's competence is a general concept related to formal education and training after graduation. When accounting standards are still new to SMEs, regular updates on accounting knowledge are indispensable for accountants. This means that recruitment and training influence greatly the making of financial statement. Many surveys of Đà Nẵng SMEs have shown that they tended to outsource accounting services, therefore the quality of these outsourced accountants is also worth studying.

Practical guideline is a characteristic of accounting services in many provinces. Empirical results, however, do not support initial hypotheses. In spite of their positive relationships with proportions of financial statement made and standards applied, all regression coefficients have no statistical significance. This problem perhaps comes from the poor quality of human resource because working experience of employees did affect greatly the application of accounting standards. Additionally, effects of practical guidelines are

trivial because most transactions undertaken by Đà Nẵng SMEs are very simple.

"Advices from business community" has a negative relationship with "proportion of financial statements made" and a positive relationship with "proportion of standards applied." However, all regression coefficients have no statistical significance except for the case in which all financial variables are eliminated from the model of proportion of standards applied.

As mentioned above, "Advices from business community" comprises advices from tax officials, independent auditors and fellow accountants. The negative relationship may be explained as follows: accountants usually seek for advices on problems with daily accounting jobs and they rarely need advices on preparation of financial statement. Regarding the positive relationship with proportion of standards applied, the positive regression coefficient implies that accountants only seek for advices when facing too many complicated transactions. In fact, auditor's advices only help deal with a specific economic transaction regulated by an accounting standard. Regression coefficients in the model only gain some statistical significance when financial variables are eliminated. This reveals the instability of the financial factor in the model.

"Owner's interest in accounting job" has positive relationships in the model but the regression coefficient is not statistically significant. This is contrary to our prediction that the accounting task is determined by owner's intention to achieve his/her own purposes. Lengthy discussions with accountants and enterprise owners, however, show that the owner is usually interested in book keeping for tax purpose instead of accounting one.

Concerning the effects of inspection and auditing, two dummy variables are used in this research to cope with ways of SME management. In the model of proportion of financial statements made, the regression coefficient is statistically significant at 10% when all variables are included, and at 1% when financial variables are eliminated. This means that more financial statements will be made when these statements are inspected and audited. This result raises a question about the task of auditing and inspecting financial statements of SMEs because this task can make such statements more honest and rational.

Profitability has a negative relationship with the application of accounting standards in both models but it is not statistically significant. Similarly, debt structure and enterprise size also have no significance in the model. These results imply that factors related to characteristics of enterprise cannot convincingly explain the effort to apply accounting standards by Đà Nẵng SMEs. In other words, accounting information from SMEs is not an important basis for business decisions by investors and related partners. In fact, many loan officials say that their decisions on lending contracts are usually based on security and business plans instead of financial statements. Moreover, auditing SME financial statements are not compulsory, and therefore they are usually used as an additional source of information instead of a basis for business decisions. This fact is worth thinking about whenever effort to reform the accounting job among surveyed SMEs produces no result.

## 5. Conclusion

Research results imply the following important points:

**Firstly**, proportion of accounting standards applied in Đà Nẵng is below 50%. The most widely used ones are related to sales, fixed assets, inventory, and presentation of financial statement. This feature is consistent with Đà Nẵng SMEs because they mainly engage in trading and service businesses at a small scale, and can hardly take part in complicated business transactions.

**Secondly**, human resources are considered as the most influential factor in the application of accounting standards by Đà Nẵng SMEs. Remaining factors, although their effects have no statistical significance when the model is developed, inspire many thoughts about value of information to business circles from SME financial statements, which requires further researches on factors affecting the application of accounting standards in the context of economic integration.

**Finally**, the inspection and auditing processes of SMEs should be enhanced. Although research results with both models are not consistent, it is apparent that auditing firms and the state inspection can affect considerably the application of accounting standards among Đà Nẵng SMEs, which, in its turn, may help improve quality of information in SME financial statements ■

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