



ASSESSMENT OF ACCOUNTING AND REPORTING PRACTICE OF CATEGORY A TAX PAYER BUSINESSES IN DEBREMARKOS, ETHIOPIA

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Abstract

This study Investigates and evaluate the accounting and reporting practice of category A tax payer businesses in Debre markos Town. The study adopted descriptive research method with qualitative data analysis approaches. Data were collected through both questionnaire and document analysis. The findings of the study show that there are businesses which employed single entry bookkeeping method and cash basis of accounting which is contrary to modern accounting practice. Most businesses faced problem of on time report preparation. Many businesses prepare report annually most of the time for tax purpose. The study identified that category A tax payer businesses in Debre markos face challenges in their accounting practices. These challenges include: lack of accountancy skill, lack of resources, concern only for Specific user targeted reports for government, lack of adequate skills amongst the preparers and users of financial statements to apply IFRS, lack of automation and Low insight of business owners and managers on relevance of accounting information for decision making and performance. Therefore, the researcher recommended that the businesses must provide further training to their accountants about accounting standards. These businesses need to hire professional accountants or provide education and training opportunity for existing employees to use accounting software as needed. As there is lack of adequate professionals with practical IFRS conversion experience, many businesses need to rely on external consultants and external auditing firm's guidance and perform correct asset valuation.

Keywords: *accounting, standards, financial statement, report*

1. Introduction:

The essential characteristics of accounting are the identification, measurement, and communication of financial information about economic entities to interested parties. Accounting is the process that culminates in the preparation of financial reports on the enterprise for use by both internal and external parties. Users of these financial reports include investors, creditors, managers, unions, and government agencies. In contrast, managerial accounting is the process of identifying, measuring, analyzing, and communicating financial information needed by management to plan, control, and evaluates a company's operations (E. Kieso et al 2019).

Financial reporting is very critical to ensuring the survival and growth of every business unit. Accounting practice can also be seen as the system of procedures and controls that an accounting department uses to create and record business transactions (A. Agir 2017).

Accounting plays a critical role in the success or failure of modern business institutions. Accounting systems are responsible for recording, analyzing, monitoring and evaluating the financial condition of companies, preparation of documents necessary for tax purposes, providing information support to many others organizational functions (N, Manyani 2011). Sound decision made by individuals, business, government and other entities are essential for the efficient distribution and use of scarce resource. To make such decisions, these groups must have reliable

information provided by the accounting system (E. Kieso et al 2019).

According to current Ethiopia federal income tax proclamation No 979 /2016 tax payers are categorized in to three namely “A”, “B” “C” based on annual turnovers. Category A taxpayers being a body or any other businesses having an annual gross income of Ethiopian birr 1,000,000 or more. The large scale enterprise that is category A this include any company incorporated under the law of Ethiopia or in a foreign country and any other business having an annual turnover of Birr 1,000,000 or more and they are liable for business income tax shall keep books of account prepared in accordance with the financial accounting reporting standards. They are required to submit to the Tax Authority at the end of the year a balance sheet and a profit and loss statement and other details. This study therefore aimed to investigate accounting and reporting practice of category A tax payer businesses in Debremarkos, Ethiopia.

2. Statement of the problem

The purpose of accounting system is to keep the track of transaction and recording revenue and expense of the company. It help in recording analyzing and retrieving the financial data. On the basis of financial status and financial reports important decision of an organization are made. The basic purpose of accounting system is identification of all the activities which may impact an organization financially. This activity include purchase, sale, investment made and loan lending. Moreover accounting system also provides a proper way to the companies for the monitoring and handling financial data like all data is arranged in journal entry and ledger. This also increases internal check of the organization, (Horngren. et al ,1999).

Accounting and reporting is important for both government and private organization. It should assist users in evaluating the operating result of the organization. It also used for resource allocation decision (Wilson Kattelus Hay, 1995).

Accounting and reporting is very important to assess information for different purpose. In order to provide this information, organizations prepare different type of financial report that shows the operation results and financial position of the organization (E. Kieso et al 2019).

In Ethiopia the accounting practice is limited to some yearly taxation report and some profit and loss statements. In this regard the accounting information have inadequate impact in the decision making process.

There wasn't defined accounting standard, this made the practice to be evaluated and performed in different standards which created confusion to the users of this information. But currently businesses are required to adopt and implement international financial reporting standards. Organizations that do not follow accounting principle and practice established by accounting standard setting organizations mislead users of financial statement decision. Hence, this study is undertaken to assess accounting and reporting practice of category A tax payer businesses in Debremarkos Town.

3. Objective of the study

3.1. General objective

The general objective of the study is to examine and evaluate the accounting and reporting practice of category A tax payer businesses in Debremarkos Town.

3.2. The specific objective

- Investigate whether significant number of category A tax payer businesses in Debremarkos adopts appropriate accounting practices.
- To determine the challenges category A tax payer businesses facing in adopting effective financial accounting and reporting in Debremarkos.

- To assess the problems in preparing financial report by category A tax payer businesses in Debremarkos

4. Literature Review

4.1. Theoretical Review

According to Warren (1999) accounting is the method and procedure for collecting, classifying, summarizing and reporting, a business financial and operating information. In addition, it also defined as an information system that provides report to stockholders about economic activities and conditions of business.

The purpose of accounting is to provide financial information about an economic entity. This accounting information, which is called financial statement provided by the accounting system, is required by the activity of the organization. Accounting information has many users including customers, employees, stockholders, creditors, suppliers, government, local community and the general public.

An accounting information system collects and processes transaction data and then disseminates the financial information to interested parties. Accounting information systems vary widely from one business to another. Various factors shape these systems: the nature of the business and the transactions in which it engages, the size of the firm, the volume of data to be handled, and the informational demands that management and others require. Investors are interested in financial reporting because it provides information that is useful for making decisions (S. Warren, et al, 2018).

The accounting profession has attempted to develop a set of standards that are generally accepted and universally practiced. Otherwise, each company would have to develop its own standards. Further, readers of financial statements would have to familiarize themselves with every company's peculiar accounting and reporting practices. It would be almost impossible to prepare statements that could be compared. For many years, many nations have relied on their own standard-setting organizations. For example, Canada has the Accounting Standards Board, Japan has the Accounting Standards Board of Japan, Germany has the German Accounting Standards Committee, and the United States has the Financial Accounting Standards Board (FASB). The standards issued by these organizations are sometimes principles-based, rules-based, tax-oriented, or business-based. In other words, they often differ in concept and objective. Starting in 2000, two major standard-setting bodies have emerged as the primary standard-setting bodies in the world. One organization is based in London, United Kingdom, and is called the International Accounting Standards Board (IASB). The IASB issues International Financial Reporting Standards (IFRS), which are used on most foreign exchanges. These standards may also be used by foreign companies listing on U.S. securities exchanges. As indicated earlier, IFRS is presently used in 120 countries and is rapidly gaining acceptance in other countries as well. It is generally believed that IFRS has the best potential to provide a common platform on which companies can report and investors can compare financial information. As a result, our discussion focuses (E. Kieso et al 2019).

Accounting standards in Ethiopia

International Financial Reporting Standards (IFRS) is a single set of accounting and financial reporting standards developed by International Accounting Standards Board (IASB). The standards are intended for global use by entities in all types of economies from developing countries to emerging markets to well established industrialized nations (IASB, 2016). Ethiopia mandatorily adopted IFRS and has then become part of Ethiopian Law after the House of Peoples Representative of Ethiopia has enacted Financial Reporting Standards Proclamation No.

847/2014 which was effective on the 5th of December 2014. Thus, Ethiopia is the most recent participant in the IFRS adoption chain when the Accounting and Auditing Board of Ethiopia (AABE) announced its road-map after the issuance of Regulation No.332/2014 which became effective on the 14th January, 2015. Ethiopia at a country level has chosen the adoption approach of IFRS to replace the previous inconsistent local standards.

To ensure transparency in financial reporting aimed at building confidence in the minds of investors, and local and foreign direct investors; Ethiopia as a nation has to ensure a globalization of world trade desire to adopt IFRS. In December 2014, the House of Peoples' Representatives of Ethiopia gave approval for financial reporting standards issued in Proclamation No. 847/2014 which was made effective on the 5th of December 2014. The purpose of this Proclamation is to establish a sound, transparent and understandable financial reporting system applicable to entities in private and public sectors. Having uniform financial reporting standards enhances transparency and accountability by centralizing the previous decentralized financial reporting structures of the country (FDRE, 2014, p. 7714).

4.2. Empirical literature review

Agir 2017, examined the accounting practices of SMEs as well as the challenges they face and the effect of these challenges on SMEs in Makurdi Metropolis – Benue State - Nigeria. A Survey research design was adopted for the study and a likert-scale type questionnaire was the main instrument used for data collection. Simple percentages, tables and cut-off mean were deployed for data analysis. The study found that SMEs in Makurdi Metropolis keep sales & purchase daybook and that SMEs in Makurdi Metropolis are faced with challenges of accounting practices and these challenges have a significant effect on their operations.

M. Lakew, 2017 examined Accounting and Reporting Practice of Micro and Small Enterprises in West Oromia Region, Ethiopia. The finding indicated that the majority of MSEs did not keep regular accounting record and prepare periodic financial report. The main reasons mentioned by the respondents includes: smallness of the business, expensiveness of qualified accountants and lack of awareness about the benefits of accounting.

Yohannes Fekadu 2018 assessed the usage of management accounting practice being used & to examine its effect on performance of Ethiopian cement companies using mixed research approach. The study result indicates that costing practice is the most highly used management accounting practice followed by budgeting practice by Ethiopian cement companies. The rest management accounting practices (performance evaluation, information for decision making and strategic analysis) have been given less attention by respondent companies. The study results further indicate that the independent variables; Cost Management Practices, Budget Management Practices, Performance Evaluation Management Practice, Information for Decision Making Management Practice and Strategic Analysis Management Practice are significant in explaining the performance of Ethiopian cement companies.

As large and medium scale enterprises are a significant component of the economy and there is a lack of empirical evidence along with the gap between the theory and the practice considering their accounting practice and its effect in large business enterprises in Debremarkos. Therefore, this study assessed category A tax payer large business enterprises accounting practice in Debremarkos to provide empirical evidence of this gap.

5. Research method

5.1. Research design

This study is designed as a descriptive research method with qualitative data analysis approaches. Primary and secondary data related to the accounting and reporting practice of

category A tax payer large business enterprises is used.

5.2. Types and source of data

To meet the general objective of assessment of accounting and reporting practice of category A tax payer large business enterprises in Debre Markos, the researcher tried to assess the reliabilities of periodic financial reports by using primary source of data to obtain relevant information for analysis. In order to meet the general objective this study, data were collected through both questionnaire and document analysis.

5.3. Target group and sampling technique and sample size

The target populations of the research are business income taxpayers who are subject for business profit tax of category “A” taxpayers. Therefore, the target for the sample included population consists of all business income tax payers in Debre Markos town. There are 714 category “A” business profit tax payers in Debre markos town, as the information obtained from Ethiopian revenue and custom authority of Debre markos district as of 2019.

In the study, the researcher was used judgmental sampling techniques for gathering primary source of data. Only one accounting officer/manager was selected in each sampled business to constitute the sample size.

In order to determine the sample size Yamane’s (1967) sampling size determination formula is used at 90% confidence level and 0.1 level of significance. The reason why the researchers use 90% confidence level is that most of category “A” taxpayers have homogenous character.

$$n=N/(1+N(e^2))$$

Where;

- N is the accessible population,
- n is the sample size and
- e is the error coefficient

Based on the formula the sample size is determined as:

$$n=714/(1+714(0.1^2))$$

$$n=88$$

6. Results and Discussion:

A total of 88 questionnaires were distributed to each accounting officer/manager in each sampled business selected for the study. Out of the total 88 questionnaires, 87 Useable questionnaires were obtained (98.86%) response rate.

6.1. Accounting and reporting practice

The analysis and presentation were made using tools such as percentage and tables.

Table 6.1. Accounting and reporting practices

No	Items	Respondents	
		Frequency	Percent
1	Bookkeeping method used		
	Double entry	76	87%
	Single entry	11	13%
2	The basis of accounting practiced		
	Accrual basis	60	69%
	Modified cash Basis	12	14%
	Cash basis	15	17%
3	Accounting standard followed		
	International financial reporting standard (IFRS)	-	-
	General accepted accounting standard (GAAP)	34	39%
	Not specified/ following government tax regulation	53	61%
4	There is on time report preparation		
	Yes	33	38%
	No	54	62%
5	Financial report preparation frequency		
	Monthly	10	11.5%
	Quarterly	4	4.5%
	Semiannually	21	24%
	Annually	84	96.5%
6	Accounting system		
	Manual	27	31%
	Computerized	28	32%
	Partly computerized	32	37%
7	Computerized accounting system		
	Peachtree	26	30%
	QuickBooks	2	2.3%
	Excel	32	37%
	Other		-

Source: computation by the Researchers from 2019 Survey Data

As the above table 6.1 indicates most (87%) make accounting records using double entry book keeping method and 13% use single entry bookkeeping method. Double entry book keeping method means record the transaction in two sides as a debit and credit and helps to record all aspects of a given transaction. It is more efficient and modern system as compared to a single entry system. In double entry bookkeeping system accounts are self-controlling, because the total of all debits must equal with the total of all credit. It avoids error and complexity. Therefore errors are easily detected and corrected. However as the survey result indicated there are businesses which employed single entry bookkeeping method which is contrary to modern accounting practice. These businesses used single entry bookkeeping method in capturing transactions and they tried to prepare reports for tax purpose considering the taxation regulation of the country. According to the above 69% of respondents provided response, their business use accrual basis of accounting. Among the sampled respondents 14% confirmed as their business use cash basis of accounting and the remaining 17% of sampled businesses use modified cash basis of accounting. The modified cash basis of accounting uses elements of both the cash basis and accrual basis of accounting. The modified cash basis has the following feature; Record short term items when cash level changes (the cash basis). This means that elements of the income statement are recorded using the cash basis. In modified cash basis businesses used to record long term balance sheet items with accrual basis. This means that balance sheet accounts are recorded accrual basis.

According to the survey result table none of respondents implement International Financial Reporting Standards (IFRS), 39% respond as their business applied GAAP and 61% do not apply specified standards, they prepare annual reports and tax return following government tax

regulation. As per the Ethiopian income tax proclamation 979/2016 Category A tax payers liable for business income tax shall keep books of account prepared in accordance with the financial accounting reporting standards and in particular shall keep record of the business assets and liabilities of the tax payer, including a register of fixed assets showing the acquisition date, the cost of acquisition, any costs of improvement in relation to the asset, and current net book value of the asset and a record of all daily income and expenditure related to the tax payer's business but the standard is not defined.

In Ethiopia as a nation there was no defined accounting standard. Currently Proclamation 847/2014 "Ethiopian Financial Reporting" which shall be applicable to all reporting entities established in accordance with the Ethiopian law or operating in Ethiopia and the proclamation also establish "Accounting and Auditing Board of Ethiopia". The board has the powers and duties of setting standard and directives relating to financial reporting and set criteria to distinguish reporting entities as either public interest entities or small or medium enterprises and register them accordingly.

Majority of the participants 62% reflect that there isn't on time report preparation. As the survey result revealed many businesses prepare report annually most of the time for tax purpose.

When computerized accounting system is used reports are prepared in a timely manner and reports produced from computerized accounting software allow managers to run the company in a more efficient manner. As a result most (66%) of the businesses use computerized system. There are also some businesses which use manual accounting system. The users of the manual accounting system have more intention to fulfill the minimum requirement of the record keeping; this will indicate that tax declaration is there first priority.

6.2. Challenges facing in adopting effective financial accounting and reporting

Besides evaluating accounting and reporting practice of category A tax payer businesses in Debremarkos Ethiopia, this study also looked at the challenges faced by the practitioners in adopting the IFRS and preparing relevant financial information as presented in Table 6.2. A few statements were set in the questionnaire with regards to the Challenges facing in adopting effective financial accounting and reporting and the respondents were required to rate their perceptions based on five point Likert scale with the following ratings. Strongly agree (SA; or 5), agree (A; or 4), neutral (N; or 3), disagree (D; or 2), and strongly disagree (SD; or 1). Average mean is used to measure the perceptions of our respondents on each statement with regards to the Challenges facing in adopting effective financial accounting and reporting. A mean of above 3 shows that majority of the respondents are agreeable with the given statement on the Challenges facing in adopting effective financial accounting and reporting. The result is shown in the Table 6.2 below.

Table 6.2 Challenges businesses facing in adopting effective financial accounting and reporting

No	Statements		SD	D	N	A	SA	Mean
1	Inefficient training for the accountants in the business	Frequency	-	14	8	41	24	3.8620
		%	-	16.1	9.2	47.1	27.6	
2	Cost of maintaining accounting records and reports	Frequency	15	28	8	24	12	2.8850
		%	17.2	32	9.2	27.6	14	
3	Lack of resources like material and budgets	Frequency	5	16	2	35	29	3.7701
		%	5.6	18.4	23	40	13	
4	Concern only for Specific user targeted reports	Frequency	4	10	3	52	18	3.8045
		%	4.6	11.5	3.5	59.8	20.6	
5	Keeping track of changing financial reporting standards	Frequency	6	13	5	43	20	3.6666
		%	7	15	5.7	49	23.3	
6	Lack of automation	Frequency	10	27	9	31	10	3.0459
		%	11.5	31	10	36	11.5	
7	Low insight of business owners and managers on relevance of accounting information for decision making and performance.	Frequency	2	20	10	34	21	3.5977
		%	2.3	23	11.5	39	24.2	

Source: computation by the Researchers from 2019 Survey Data

NB.SD-Strongly Disagree, DA-Disagree, N- Neutral, A-Agree, SA-Strongly Agree

The above presented survey result of the study indicated that category A tax payer businesses in Debremarkos face many challenges for implementing effective financial accounting and reporting. From the above data except statement number 2 in all other statements the mean is above 3.5 and the mode is agree. The study concludes that category A tax payer businesses in Debremarkos face challenges in their accounting practices. These challenges include: lack of knowledge and accountancy skill as a result of inefficient training for the accountants in the business, lack of resources like material and budgets, concern only for Specific user targeted reports for government, lack of adequate skills amongst the preparers and users of financial statements to apply IFRS because Proper implementation of such IFRS requires extensive education of preparers, lack of automation and Low insight of business owners and managers on relevance of accounting information for decision making and performance. The purpose of preparing report also limited to taxation, to access fund or loan. Failure to prepare financial report leads to poor performance of these businesses, failure to prepare financial report makes it difficult for the businesses to access financial assistance and absence of financial report result to inappropriate basis of budgeting.

7. Recommendation

Based on the result of the study the following recommendations have been forwarded: Modern accounting and reporting standards support accrual basis of accounting. An upside is that the accrual basis gives a more realistic idea of income and expenses during a period of time, therefore providing a long-term picture of the business that cash accounting can't provide. Therefore, the researcher recommended that the businesses must provide further training to their accountants about accounting standards. These businesses need to hire professional

accountants or provide education and training opportunity for existing employees to use accounting software as needed.

As there is lack of adequate professionals with practical IFRS conversion experience, many businesses need to rely on external consultants and external auditing firm's guidance and perform correct asset valuation. Good implementation of such IFRS requires extensive training of preparers. Hence, outsourcing of Accounting Functions may be one option.

The accounting system is among the most significant quantitative information systems in almost every organization. This system aims to provide information for some broad purposes. Formulating overall strategies and long-range plans, resource allocation decisions, cost planning and cost control of operations and activities, performance measurement and evaluation is should be based on financial information.

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