Albanian j. agric. sci. 2015;14 (3): 262-266 *Agricultural University of Tirana*

RESEARCH ARTICLE **(Open Access)**

Problems of Reliability and Informality in Financial Reporting of SME

GERTA GOGO (PERZHITA)[1], AURORA HOXHA[1], ALBANA GJONI[1]

[1]Faculty of Economy and Agribusiness, Agricultural University of Tirana

Abstract

The preparation of financial reporting in our country is regulated by Law No. 9228 "On Accounting and Financial Statements" of 2004. This law was formulated in the spirit of international accounting standards by authorizing the regulation of accounting with Accounting Standards [1] , which started to apply in January 2008 by all units with profit that operate in our country. According to the first standard of accounting which represents important principles of preparation of financial reporting, the financial statements should provide all the information necessary, complete and realistic financial position of the entity and to be unaffected during the preparation from its makers or menagement. But does it really happen to implement these principles during the preparation of financial statements, or economic units did not report complete financial situation, so there is informality? Exactly, the answer to that question constitutes the main purpose of this paper. This will be realized by the processing of data insured through a questionnaire addressed to tax inspectors in the district of Tirana, Lezhes and Peshkopi. The results showed that over 80% of entities controlled by inspectors , who participate in the questionnaire, have resulted that they do not fully report income and apply other prices from the real prices in tax bills. Also the results showed that over 70% of cases, the information reported in the financial statements is influenced by management or also by the drafters of the financial statements with the approval of the menagement. So the results indicated that the problems of informality in the financial reporting are present according to tax inspectors.

Keywords: informality, financial reporting, tax inspectors, reliability, financial statements

1. Introduction

Financial reporting for small and medium enterprises is an important topic for accounting studies because of their importance to economic development and increase competitiveness and employment in each country. SMEs are considered the engine of economic growth and development, as well as major actor in employment growth [2]. Although at first sight the preparation and financial reporting under accounting standards can be counted as an opportunity to encourage economic growth in a developing country, it should be noted that the reporting of reliable information, transparency and avoidance of informality of 98% of that country's enterprises is an important pillar for strategic and sustainable development thereof. This is because, an effective financial reporting, is a very important element to ensure a healthy business climate. On the other hand the effects of reporting "false" and distorted are multidimensional and have chain reaction effect, influencing the investment decisions of other entities, asymmetry of information in markets etc.[3]. In developed economies, informality includes fiscal evasion and undeclared work instead of unregistered businesses, otherwise of emerging economies that mark mostly unregistered businesses [4]. However, despite the negative impact on the economy and the welfare of a country, informality appears to be present [5]. This fact is determined by the responses of tax inspectors, who during tax controls exercised in economic units have identified significant problems related to credibility and the reality of the information reported in the financial statements. Furthermore, today's problems of informality are a matter enough discussed and treat not only from speciliste of the field, but also by the Albanian government.

2. Materials and Methods

The main purpose of this paper is to identify the problems of informality in preparation of financial

*Corresponding author: Gerta Gogo; E-mail: ggogo@ubt.edu.al
(Accepted for publication on September 25, 2015)
***ISSN**: 2218-2020, © Agricultural University of Tirana*

reporting of local SMEs. This putpose is realized through 45 answers of tax inspectors surveyed in 3 districts of the country. The choice of tax inspectors, as the target group for the purposes of this paper was conducted after they are evaluated as the primary responsibility to identify and avoid the problems of the informal financial reporting. Data provided through questionnaires were processed with statistical program SPSS (version 20), giving a descriptive presentation of financial reporting problems.

3. Results and Discussion

1.1 Characteristics of the target group

Initially, inspectors surveyed were asked if they have checked financial statements of small and medium enterprises, to identify if the information received from them answers the object of this paper. The results showed that 97.8% of respondents confirmed this fact, confirming that the sample of the respondents meets the object of this study. Regarding the main characteristics of the target group showed that 53.3% of the surveyed inspectors are female and 47.6% male. Most of the inspectors surveyed or 35.6% of them belong to the age group 41-50 years and 26.7% of them belong to the age group 51-60 years. So, we note that over 50% of the inspectors surveyed by tax departments are on average age 40 years to 60 years. Meanwhile, the lowest level, 6.7%, is in the age group 22-30 years and above 60 years. In terms of educational level it showed that 20% of respondents have not only completed Bachelor but also Master Degree. On the other hand over 50% of them resulted in over 10 years working experience, meanwhile 15.6% of them have over 30 years of experience. While 31.1% of inspectors have up to 10 years had experience working. All respondents, for the requirements of the job position they have the profession of accountat/financier. This occupation is confirm by 75.6% of inspectors surveyed, while 13.3% of them have the title "Accountant". Mostly, the respondents are employed in tax institutions in Tirana and a few in other districts.

1.2 Results on problems of reliability and informality in financial reporting

Since the law on accounting conditonal the preparation and the reporte of financial according to national accounting standards, this means that SMEs are urged to implement fully and correctly these standards. When asked about this issue, tax inspectors had acknowledged that the implementation of standards is not complete and continues to be associated with problems (refer to Figure1).

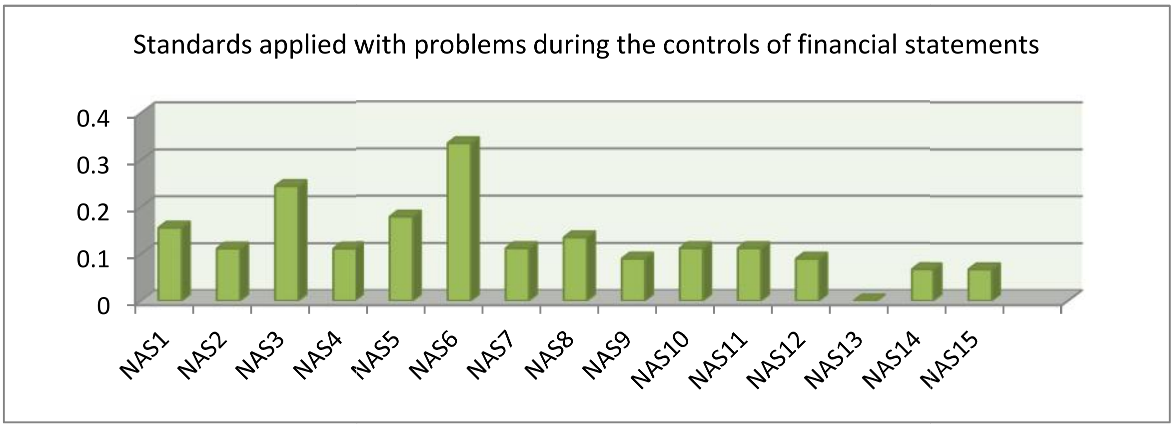


Figura 1. Standards applied with problems during the controls of financial statements by the inspectors (authors)

Among the standards that have more problems in their implementation are NAS 3 (National Accountin Standarts), NAS5 and NAS6. Also, as seen in Figure 1 also the first accounting standard (NAS1) is mentioned by the respondents as one of the standards applied with problems. This standard defines the rules and main principles of the NAS, according to which "financial statements should give all necessary information to present a true and fair financial position, financial performance and cash flows of the reporting entity". Incomplete implementation of these principles by the drafters creates major problems of reliability and informality reported in financial statements of SMEs. In this regard, it requested the opinion of the inspectors on the reliability and completeness of transactions and events that are reported in the financial statements of entities controlled by them. Given that most experts in the field of accounting, expressing the view that some items, which are not reported fully or accurately in a business are revenues from sales (are not declared completely) or prices (apply different prices from those reported in tax bills). Based on these thoughts were drafted two questions, which were asked for the opinion of the inspectors in relation to these two problems. The results showed that 73% of the inspectors agreed that from 1% to 30% of the entities controlled of them have recorded sales without accompanied by tax invoice (have hid the income or tax evasion). While 5% of them said that 30-50% of entities controlled by them resulting not fully declare income derived by the real activity of the entity. On the other hand, only 20% of the inspectors recognize that in any entity controlled by them have not hiding income records. So there is a big difference (80% agree/20% oppose), among respondents who accept that entities report incomes diffrently than incomes derived during their activity (refer Figure 2).

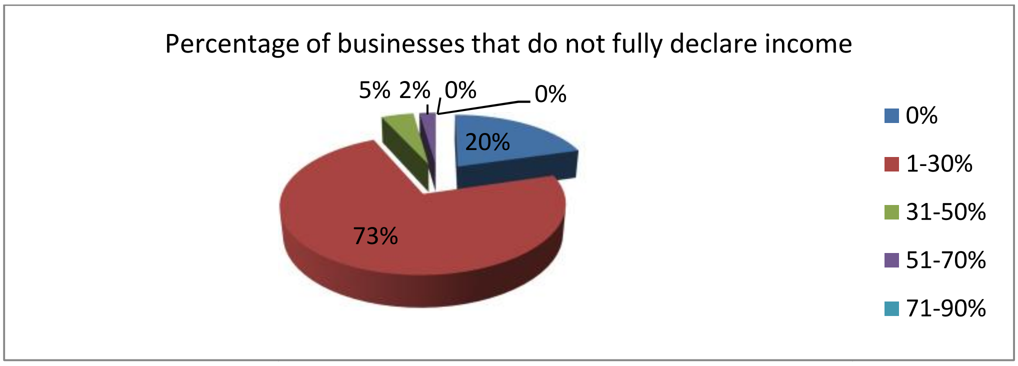


Figure 2. Percentage of businesses that do not fully declare income (authors)

While the findings regarding the application of different prices than those charged to tax authorities, showed that over 70% of respondents have encountered this problem. This is because 62% of respondents admitted that up to 30% of entities controlled by them report different prices in tax bills against the real prices apply to customers. Also 8% of respondents admit they are facing this problem to 50% of entities controlled by them. On the other hand 27% of respondents admit that they have not identified in their work entity applying different prices than those billed. (refer to Figure 3).

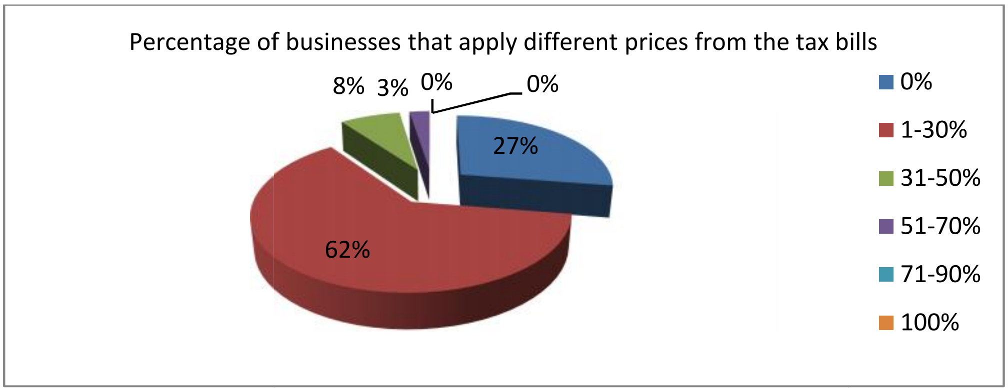


Figure 3. Percentage of businesses that apply different prices from the tax bills

Searching futher for these problems we analyzed the responses of tax inspectors in two departments of tax in Tirana, namely the Large Taxpayers Department (LTD) - Regional Department of Large Taxpayers responsible for collecting the tax revenue, social security contributions and taxes for entities that realize a turnover exceeding 180 million and the Regional Department of Tirana (RTD) - Regional Tax Department is responsible for the collection of tax revenues, social security contributions and taxes for entities that realize turnover below 180 million, with the aim of identifying the problems by size of SMEs. The results showed that, as the LTD's inspectors and RTD's inspectors also confirmed the presence of absence of full and real reporting on the financial statements of SMEs, but they are more present in small and medium enterprises. Another question directed to inspectors, to assess the reliability of the information reported in the financial statements, relates to the overall percentage of the real situation in the financial reporting of SME. Their responses confirmed that the financial statements reflect the real activity of entities in level of 70% to 90%. These results were accepted by 58% of respondents. While 20% of them admit that the values in the financial statements report 50-70% of the real financial situation of the entity. These two levels are recognized by both inspectors of LTD also the RTD. Also 3 RTD's inspectors or 7% of them exceeding deepen the relationship between the real numbers and numbers reported in financial statements in levels of 30-50%. Noteworthy is the fact that only 4% of respondents or two of them, exactly on equal between two tax institutions, recognize that values in the financial statements reflect the real activity of the entity at level 100%. So, the results showed that over 95% of respondents (43 inspectors), admitted that the numbers reported in the financial statements are different than the real numbers of entity activity. So SMEs do not report complete information on the real financial situation of their activity. (refer to figure 4).

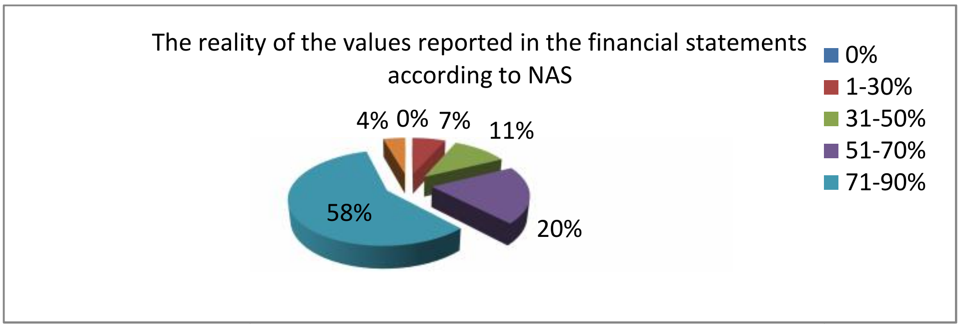
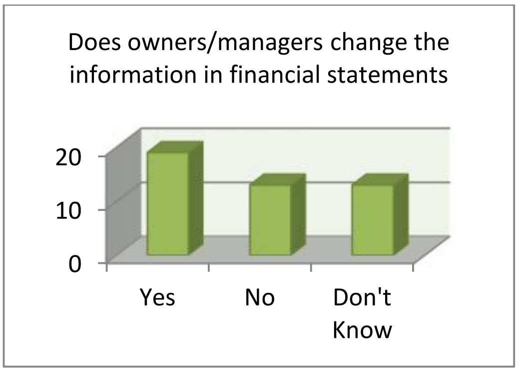


Figure 4. The reality of the values reported in the financial statements according to NAS (authors)

On the other hand, according to NAS1 "to be credible the information presented in the financial statements must be neutral, which means uninfluenced by the way information is selected or presented, in order to achieve a predetermined outcome". To arrive at a more complete conclusion about the reliability of the information reported in the financial statements of SMEs, the inspectors were asked if they noticed or not the violation of this principle. Initially, the inspectors were asked if they identified cases (entity) that managers / owners affect the information reported in the financial statements (refer Figure 5).



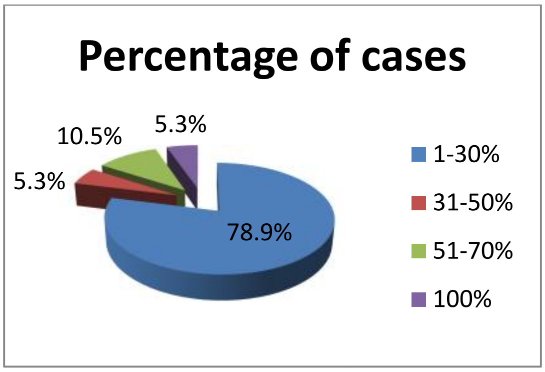


Figure 5. Impact of owners/managers on changing the information in financial statements (authors)

The results showed that 19 inspectors (42.2% of respondents) admitted that they encountered during their work in such cases. While 13 inspectors (28.9% of respondents) refused such problem. On the other hand, 13 inspectors said they are not aware about this problem. So note that a relatively high number of respondents have no information. Further more, 19 inspectors responded positively, were asked for the definition of specific cases. According to 15 inspectors (78.9%), who agreed to have recorded cases of the influence of managers / owners in annual result, it was recognized that this impact is encountered up to 30% of entities controlled by them in the past 5 years. On the other hand, 2 of them (10.5%) admitted they had identified this problem up to 70% of entities. While only one inspector (5.3%) admits that this problem has been evident in all entities during the past 5 years.

4. Conclusions

After analyzing the reliability and informality of financial reporting was concluded that most part of tax inspectors respondents recognize that entities regardless of size, medium or small, report partly true financial condition of the activity conducted. Although it should be noted that the respondents agreed that economic medium units reporting higher levels compared with the small economic units and mikro units. Mainly economic units tend to hide income, a fact accepted by over 80% of tax inspectors. They agreed that during controls exercised during their work, over 90% of economic units have proved not to declare to the tax authorities of all revenue accrued, but on average up to 70% of them. Entities apply different sales prices from those who register in tax bills and in 70% cases the numbers reported in the financial statements are influenced by managers/owners or preparers of financial statements of the entity. Against these results, it is understandable that problems over reliability and informality in the financial report, constitute a inhibiting factor of economic development and welfare in the country. However, it should be specified that from 1 September 2015 the government of Albania has taken an initiative against informality and reporting partial financial by entities, setting up working groups composed by tax inspectors, the results of which will constitute a subject of discussion in the studies further.

5. References

1. Haji .L (2012) **Developments in the field of accounting and accounting professions**. National conference "Accounting in the annual 100"; Tirana, November 2012

2. UNCTAD (United Nations Conference Trade and Development) (2000a) **Accounting by Small and Medium - sized enterprises**: Report by the UNCTAD secretariat, Geneva

3. Lati L (2012), **The Role of Accounting Information to increase konkurrueshmërinë**, National Conference "Accounting in the annual 100"; Tirana, November 2012

4. Oviedo, Ana Maria. **Economic Informality: Causes, Costs, and Policies**: A Literature Survey of International Experience." Prepared draft background paper for Turkey Country Economic Memorandum-Informality: Causes, Consequences, Policies. World Bank, Washington, DC (2009).

5. http://www.financa.gov.al/