RELATIONSHIP BETWEEN FINANCIAL REPORTING AND ANALYSIS PRACTICES AND FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES (SMES) IN SRI LANKA.

K.J.M.M. Jagoda
Department of Accounting, University of Sri Jayewardenepura
A.G.M.N Madadeniya
Department of Accounting, University of Sri Jayewardenepura
K.A.P Ravinath
Department of Accounting, University of Sri Jayewardenepura
W.P.M Ranaweera
Department of Accounting, University of Sri Jayewardenepura
H.P.I.P Pushpakumara
Department of Accounting, University of Sri Jayewardenepura

Abstract

Key purpose of the study was to identify the relationship between financial reporting practices and financial performance of small and medium-sized enterprise in Western province, Sri Lanka. SMEs have identified as an important sector because SMEs are involving to employment, contribute to the Gross Domestic Production (GDP), embarking on innovation and poverty alleviation. By considering the availability of data and time constraints etc. the researcher selected the target sample of 100 SMEs and 85 SMEs have been responded, operating their businesses in the manufacturing and building and construction sector and the study is limited to the western province in Sri Lanka. The study adopted a descriptive statistic. A questionnaire through email was chosen as a primary data collection method. The sample has collected by using stratified random sampling method to select the sample by using SPSS software and presented through percentages, means, standard deviations and frequencies. Two measures namely return on assets and net profits are used as proxies to measure performance of SMEs. To measure the relationship between the variables, a regression and correlation analysis was used to analyze the collected data. The results suggested that there is a significant relationship between financial reporting practices and financial performance of small and medium-sized enterprise in Western province, Sri Lanka. Furthermore, it was found that financial reporting practices affect to enhance the financial performance of SMEs in Sri Lanka.

Keywords: Small and Medium-sized Enterprises, financial Reporting Practices, Financial Performance

1. Introduction

1.1 Background of the Study

The Small and Medium Enterprise sector is a backbone of the all developed as well as the developing nations. Small & Medium Enterprises (SMEs) have identified as a very important sector in helping growth and the social developments of Sri Lanka because SMEs are major sources of employment, poverty alleviation, income generation and regional development. There are 96% of industrial units, 36% of industrial employment and 20% of value added in the manufacturing sector of SMEs. The contribution of SMEs in Sri Lanka to the national economy is difficult to estimate due to the scarcity of information. (White paper, 2002).

Accounting information help to manage short-term problems of SMEs in critical areas such as cash flow, costing and expenditure by providing information to monitor and control the business. Decision makers can take sound economic decisions if there is proper accounting information. (Rathnasiri, 2014)

According to Eloho (2 016) the inefficient use of accounting information and poor record keeping are affected to the financial decision-making and low quality financial data. These are the main problems which financial management has to concern. Proper record keeping is a useful system for making sound economic decisions and the success of the business. The misuse, poor record keeping, untimely and inaccuracy of accounting information effects to inaccurately assess of the financial situation of SME and make poor financial decisions.

Financial reporting system of an entity is essential to ensure that the economic resources of the SME are used in efficiently and effectively in pursuit its goals. And also it follows that there are specific needs in growing SMEs for skills in the financial analysis which allow financial statements for reading and understanding, whether they are contained historical information or forecast information (McMahon, 1995)

The researcher has designed the structure of the study depend on the relative empirical studies through different academics in the field. All the variables and dimensions has been defined in accordance with these scholastic studies. Through this research will be taken an attempt to ascertain the comprehensiveness of financial reporting practices adopted by SMEs in western province, Sri Lanka and evaluate whether there is a relationship between financial reporting practices and financial performance of these organization.

2. Research Problem

2.1 Problem Statement

Small and Medium-sized Enterprises are very important segment in economy. These enterprises facilitate to the economy in the development of a country and play an important role in both developed and developing countries. They contribute to the growth and social development of Sri Lanka through employment generation, poverty alleviation and new venture developments. Central Bank of Sri Lanka (1998) has been found that SMEs have to face many difficulties due to inadequate capital, use of outdated technology, inadequate institutional credit facilities, inadequate knowledge, improper accounting techniques and inattentiveness of small businesses.

Unfortunately, most of SMEs lack of funding from bank and other financial institutions because this sector is like to be a high risk investment area due to there is bad accounting practices. And also the SME sector fails to produce proper financial reports for better assessment. (Mintah, HayfordAdjei, MintahOffeh, Anokye, 2014)

According to Eloho (2016) the misuse, poor record keeping, untimely and inaccuracy of accounting information effects to inaccurately assess of the financial situation of SME and make poor financial decisions. Because of these issues SMEs have to face many difficulties to succeed and raise funds or borrowings. In the worst case, this sector might face with the failure and bankruptcy at the end. Thus, SMEs cannot perform well. Therefore, SMEs should concern about the financial reporting that relates to the preparation and use of financial reports such as statement of financial position, statement of comprehensive income, cash-flow statement and the statement of changes in equity.

There is limited information that relates to the relationship between Financial Reporting Practices and financial performance of small and medium enterprise in Sri Lanka. Therefore, this study seeks to fill the existing research gap by answering the research question, whether there is a relationship between financial reporting practices and financial performance of small and medium enterprise in Sri Lanka.

2.2 Research question

Whether there is a relationship between financial reporting practices and financial performance of small and medium enterprise in western province, Sri Lanka?

3. Objectives of the Study

Author of the study expects to identify, whether there is a relationship between Financial Reporting Practices and Financial Performance of Small and Medium-sized Enterprises in Western province, Sri Lanka through this study as its main objective. Another objective of this study would be investigating the impact of financial reporting practices on the financial performance of small and medium-sized enterprises.

4. Literature Review

4.1 Introduction

In this chapter it is discussed about the all the relevant theoretical studies that have been done by different researchers in relate of this study. Firstly, it has reviewed the SMEs, financial reporting practices and financial performance. Further, it is expanded to the major theoretical areas which have enriched the research design. And also the major variables explained with their relationships.

4.2 Small and Medium Enterprises in Sri Lanka

Different countries use different types of definitions for SMEs based on the development level of the country. The commonly used measures are annual turnover, total number of employees and total investment. SME policy framework (Ministry of Industry and commerce, n.d.) defines SMEs which based on the annual turnover and number of employees as which an annual turnover of the business not exceeding Rs.750 Mn and employ less than 300 employees. In terms of the definition, both conditions are reflected in defining SMEs.

Small and Medium sized Enterprises are very important strategic sector in Sri Lanka that contribute to the promoting growth and social development because SMEs are major sources of employment, poverty alleviation, income generation and regional development (White paper, 2002). Therefore, it is important to increase growth of SMEs in order to obtain sustainable development for the developing countries. Accounting information is very important to manage short-term problems like expenditure, costing and cash flow problems by providing financial information to support monitoring and control of the business (Mitchell, F. and Reid, G, 2000)

According to (Sarapaivanich, 2003) SMEs often face to accounting and financial management issues due to inadequate financial reporting practices that included poor record keeping and inefficient use of accounting information to make sound financial decisions and the low quality and unreliability of financial data. Also, proper record keeping and accounting practices help to make sound economic decisions for the purpose of success of small businesses. The inaccurate and poorly recorded accounting information leads SMEs to measure their financial situation imprecisely. In the worst case, SMEs have to fail and possible to bankrupt at the end. These short coming issues cause to difficulties when raising funds or borrowings.

4.3 Financial Reporting Practices

Financial reporting involves communicating financial information to the management and other stakeholders that regarding to the performance of the business throughout the specific time period. It helps to the management, investors and other stakeholders to take sound economic decisions. IASB requires SMEs to prepare financial statements such as Statement of Financial Position, Statement of Comprehensive Income, and Statement of Changes in equity, Statements of Cash flows and notes to the Financial Statements (Dawuda & Azek, 2015)

Abusomwan & Oghogho (2016) examined the importance of financial reporting and analysis; unfortunately found that these practices are lacking and inadequate among SMEs. There is limited usage of financial reports that attributed to the inability to employ professional managers of SMEs with functional specialization in the financial area due to limited financial resources of them. SMEs are losing out without effective and adequate financial reporting and analysis practices such as improved ability to anticipate fortunes or failures, improved monitoring of financial health and progress, greater ease in financial planning and control and better assessments of financial risks. The primary concern in SME's financial reporting practices is the preparation and use of financial reports such as the statement of financial position, the income statement, and the cash-flow statement. Both historical and future-oriented financial reporting might also be expected. And also financial reporting practices are extending to the analysis and interpretation of the historical financial statements.

4.4 Management Practices

Financial management consists planning, organizing, leading and controlling financial activities of the business such as the procurement procedure and utilization of funds of the business. Financial management activities concern about the acquisition of financial resources and ensure the effective and efficient use of them (MUINDE, 2013). Financial management decisions consist investment decisions that refer to the planning and managing long-term investments of the business. Investment (Capital budgeting) techniques consist the non-discounted cash flow techniques and discounted cash flow techniques (Gitman, 2007).

According to (Padachi, 2012) a large number of SMEs failure due to inability of skilled financial managers and accountants to plan and control current assets and current liabilities of their firms. In particular, SMEs face serious problems due to their specific characteristics and operating conditions. SMEs face resource poverty such as capital, knowledge, proper accounting packages and time creates a situation where responsibilities for managers of the firm. Thus management time, scarce resource and thus has a high opportunity cost. Certain these constraints, SMEs have limited time and other resources to provide a proper training in financial management skills in reporting practices include leading accountants to keep financial records well and other management activities.

4.5 Analysis Practices

Owners and managers can use the analysis of financial statements to assess the past and current financial condition of the business, identify any existing financial problems in SME, and prediction of future trends in the financial position of the firm. Regular preparation and analysis of the financial statements helps owners and managers to detect the problems that facing by SMEs such as sluggish sales, high operating expenses, excessive fixed asset, poor cash management and inventory mismanagement (Virginia Small Business Development Center Network, 2011). Financial ratios are an easy and valuable way to interpret numbers which are found in financial statements. Ratio analysis is a best method to identify the relationship between figures on spreadsheets. It helps to answer some critical questions such as whether customers are paying according to terms, whether the business is carrying excess debt or inventory and whether the operating expenses are too high or not.

4.6 Inventory Management Practices

Inventory management has significance important for any enterprise, an inventory concentrates manufacturing sector because effective practices in inventory management allow minimizing inventory costs. Therefore, avoid the horrible consequences which are coming with a shortage of material. This succession of events has a special significance in SMEs and inventory management. (Eloranta & Raisanen, 1998) argue that poor quality of inventory forecasts is main factors that contributing to this sequence of events in SMEs.

According to (Chikan, 1990) combined production-inventory system is a conclusive success factor under a variety of conditions. However, regarding performance, SMEs are frequently satisfied with the year-end stocktaking, profit and loss accounts. The statement of financial position rules even many benefits can be derived from applying a perpetual inventory system. This type of inventory system, all the stock items is randomly and periodically checked over the year. But many SMEs are lack of professional expertise and take decisions generally based on the intuition and elementary inventory management practices, investments in inventory are not always measure accurately or appropriately. Inventory management is a crucial event to the SME because mismanagement of inventory management may threaten to the enterprise's survival (Sprague & Wacker, 1996). The inventory management has an important comportment on the competitiveness and financial strength of the SME due to it directly affects to the working capital, customer services and production. There are many practices for effective inventory management in a manufacturing enterprise. There are traditional inventory management practices as Always Better Control (ABC) practice and order quantity purchase and modern inventory management practices as Vendor Managed Inventory (VMI) and computerized inventory accounting Just-in time (JIT).

4.7 Financial Performance of SMEs

According to (Firer & Williams, 2003) the management always try to maximize the owner's wealth of the business by maximizing the value of its shareholders. The market price of the common stock is the value of the firm, which is a reflection of the investment, financing, and dividend decisions that represents prospective future earnings per share, risk of earnings, and any other factors which effect to the market price of the stock. The market price assists as a performance index or a report card on the progress of the firm.

Poor accounting and management practices are major factors that resist financial performance of SMEs and it disturbs to raise finance. Information asymmetries related with the lending from borrowers to smaller enterprises. Because of these non-financial reasons, a large number of small and medium enterprises have to face different types of failure. And also lack of basic management experiences and poor record keeping contribute to the failure of small business. (Liedholm C, MacPherson M & Chuta E, 2007)

5. Methodology

5.1 Introduction

This chapter describes the methodology of the study. The researcher supposed to provide a summary of the methods accepted to investigate the research problem. It involves a blueprint for explaining operationalization of the variables, methods of data collection, sample selection procedure, research design and the methods of data analysis and evaluation techniques and the conceptual framework of this research. Under operationalization of the variables was explained and in this section the methodology and the organizational details will be discussed.

A literature review is directed to form a theoretical framework. semi structured questionnaire and interviews with SME's owners and analyzing and forecasting of their financial reports were conducted to collect primary data to understand the relationship between financial reporting practices and financial performance in SME's in western province. Also secondary data have been collected and analyzed from published material and information from other sources as annual report.

5.2 Population and Study Sample

This presents the findings on the study to determine the relationship between financial reporting and analysis practices and financial performance of small and medium enterprises in Sri Lanka. The targeted population was SMEs in Sri Lanka and the sample size was 100 SMEs in Colombo, Gampaha and Kaluthara districts. It was selected based on the revenue, net profit and returns on assets. That response was a satisfactory to make a conclusion for this study. Descriptive and inferential statistics was used to discuss the findings of the study. This was aimed to reduce the standard error by providing some control over the variances.

5.3 Conceptual diagram

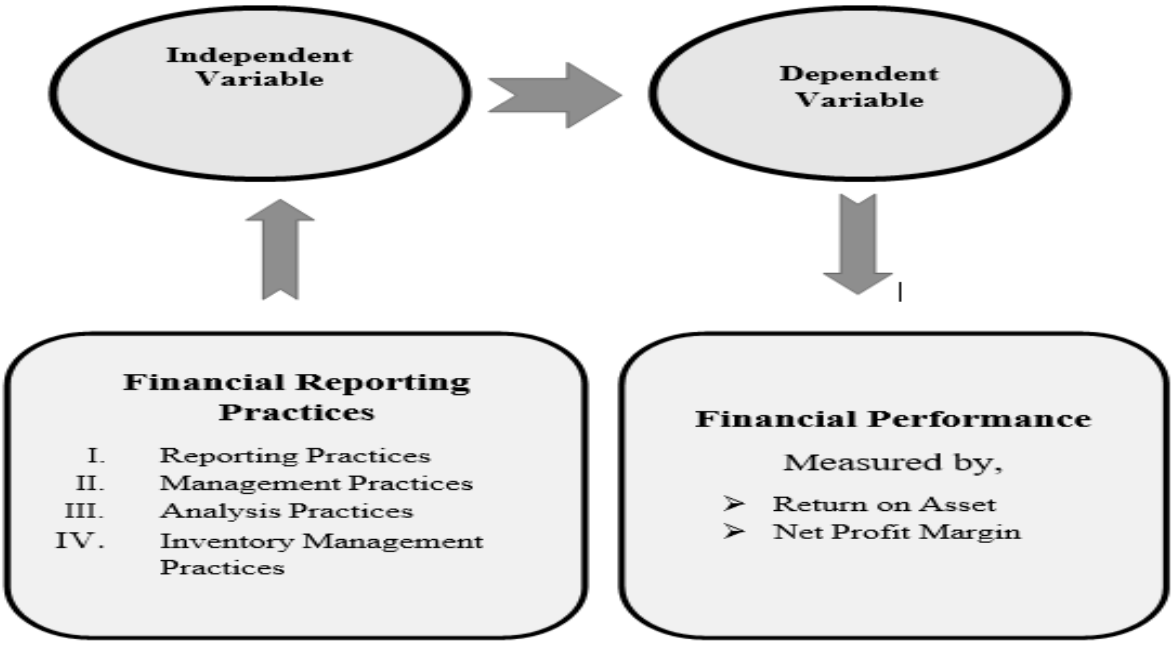


Figure: 1 Conceptual diagram

5.4 Operationalization of the Variables

Below illustrates the operationalization of the selected dependent, independent and control variables.

5.4.1 Independent Variables

5.4.1.1 Financial Reporting and Analysis

Financial reporting involves the communication of financial information's to the management as well as to stakeholders about the performance of the company over the specific time period. It is help to the management and other stakeholders to take economic decisions. This accounting information's are associated with the success and the failure of the SME. Therefore, firms should prepare financial statements and analyze basically Statement of Financial Position, Income statement and Cash flow Statement.

(Drury, C. & Tayles, M., 1995) has concluded that the same rules and procedures that established for external reporting (financial accounting) are likely to be applied to internal reporting (management accounting). Though the external and internal reporting tends to employ same rules, it does not mean that the management accounting is compliant to financial accounting. The reason is most companies adopt with the identical practices for both reporting systems are that firms prefer their internal profit to report consistently with the external financial accounting requirements.

5.4.1.2 Financial management practices

Under this, study will be analyzed the management practices such as recording transactions are charged by the manager or owner, business accounting system, the staff and efficiency of operation of the accounting department and computer based software in recording transactions.

5.4.1.3 Financial analysis practices

This study will be consider whether SMEs use financial analysis such as liquidity ratios, efficiency ratios, leverage ratios, internally generated cash sources, easy access to bank loans and capital structure based on the theory.

5.4.1.4 Investment analysis practices

Under this analysis, will be analyzed whether the firm has cash for investment in long term projects, invest in non-current assets, fully utilizes the non-currents, uses of payback period to access the investment, invest without evaluating the investment and whether business review the investment projects after a certain period.

5.4.1.5 Inventory Management Practices

According to this study, the survey will be analyzed inventory management practices such as physical safeguards of inventory against theft, inventory levels are determine based on owner's experiences, use of standard cost, periodic review on overhead rates, preparation and usage of periodic summaries of inventory usage, proper authorization for purchase, inventory count and computation of inventory turnover ratios.

5.4.2 Dependent Variables

5.4.2.1 Return on Asset

Return on Asset (ROA) describe that how profitability of a company relative to its total assets. It give an idea hoe manage assets of the company efficiently to generate earnings. ROA can be calculated as follows;

$$\text{Return on Assets} = \frac{\text{Net Income}}{\text{Total Assets}}$$

5.4.2.2 Net Profit

Net profit is the revenue after deducting operation expenses, interest, tax, and dividend on preferred stock.

$$\textit{Net Profit} = \textit{Total Revenue} - \textit{Total Expenses}$$

5.5 Hypothesis Development

In order to reply the questions of the research, the following hypothesis were developed.

H1: There is no relationship between financial reporting practices and financial performance of small and medium enterprise.

H1A: There is a significant relationship between financial reporting practices and financial performance of small and medium enterprise.

H2: There is no relationship between reporting practices and financial performance.

H2A: There is a significant relationship between reporting practices and financial performance.

H3: There is no relationship between management practices and financial performance.

H3A: There is a significant relationship between management practices and financial performance.

H4: There is no relationship between analysis practices and financial performance.

H4A: There is a significant relationship between analysis practices and financial performance.

H5: There is no relationship between inventory management practices and financial performance

H5A: There is a significant relationship between inventory management practices and financial performance.

5.6 Analytical strategies

The following regression model was used in this study;

$$Y = \beta 0 + \beta 1FR + \beta 2\ FA + \beta 3FM + \beta 4IA + \beta 4IM + \varepsilon$$

Where,

Y = Financial performance of SMEs which will be measured by return on assets and net profits of the firm; it is also measure using the questionnaire.

FR = Financial Reporting; will be measured by the comprehensiveness of financial reporting practices used by small and medium enterprise, this is measured using various statements on financial reporting.

FA = Financial analysis, will be measured by the comprehensiveness of financial analysis practices used by small and medium enterprise; this is measured using various statements on financial accounting.

FM = Financial Management, this will be measured by the comprehensiveness of financial management practices used by small and medium enterprise; this is measured using various statements on financial Management.

IA = Investment analysis, this will be measured by the comprehensive of management accounting practices used by small and medium enterprise; this will measure using various statements on management accounting.

IM = Inventory Management, this will be measured by the comprehensive of management accounting practices used by small and medium enterprise, this will measure using various statements on management accounting.

ε = error term

6. Analysis and Discussion

6.1 Introduction

The objective of this chapter is to present and analyze the data collated through the survey. In order to achieve this objective, the study focused entirely into SMEs sector mainly consists of eighty five (85) manufacturing, building and construction companies. The study constitutes from correlation and regression results in determining the relationship between financial reporting practices and financial performance of SMEs in Western province, Sri Lanka by carrying out correlation and regression model using SPSS software to find the descriptive statistics, correlation among variables and finally to ascertain the impact of the independent variables on the dependent variable.

Table: 1 Study Response

Total No of Distributed Questionnaires	Total Response to the Questionnaires	Not Response	Response Rate
100	85	15	85%

(Source – Survey Data, 2018)

Above table describes the final result of the survey carried out to identify the relationship between the financial reporting practice and financial performances of SMEs in Sri Lanka. Data was gathered by using questionnaires while selecting the whole population of the SMEs in western province.

6.2 Test of Reliability

The reliability of a measure is established to test both consistency and stability of the data set. Consistency indicates that how well the items measuring the concept hang together as a set. The reliability is measured through Cronbach's alpha and it is a reliability coefficient that indicates how well the items in a set are positively correlated to one another.

Table: 2 Reliability Test

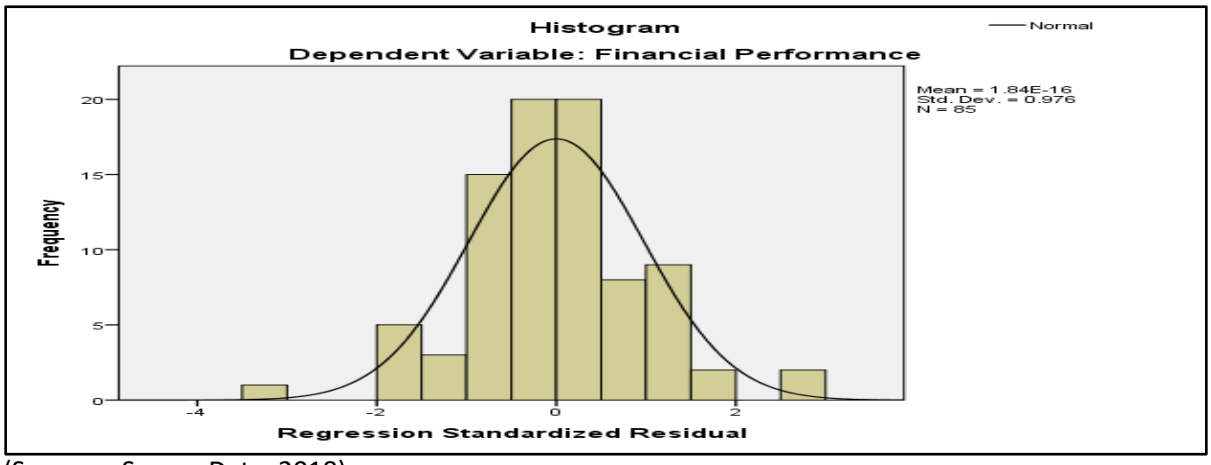
Variable	No. of Items	Cronbach's alpha
Financial Performance	2	0.954
Reporting Practices	6	0.982
Management Practices	4	0.827
Analysis Practices	4	0.512
Inventory Management Practices	5	0.760

(Source – Survey Data, 2018)

Reliability Analysis was employed to measure the accuracy of the collected data and to ensure that all the items in each variable are free from errors. Decision criteria to select the question is, Cronbach's alpha value have to be more than 0.7. There are four cut-off points for reliability, according to Hinton et al. (2004), which includes excellent reliability (0.90 and above), high reliability (0.70-0.90), moderate reliability (0.50-0.70) and low reliability (0.50 and below).

6.3 Test of Normality

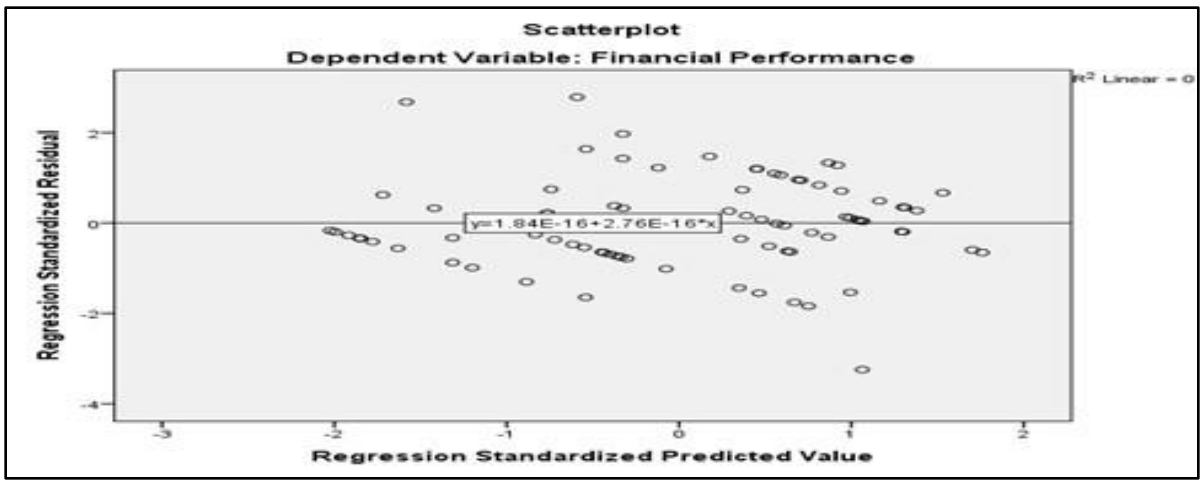
Figure: 2 Normality test on histogram



(Source – Survey Data, 2018)

To test the normality of residuals, histogram, normal probability plot and scatterplot can be used. Above histogram seems like a normal distribution as it has a bell-shaped curve.

Figure: 3 Normal Probability Plot and Scatter Plot



Both frequency distribution normal P-P plot of regression shows a normal distribution. Scatterplot in figure: 3 show that the residuals fall within a generally random pattern as it does not display any nonlinear pattern. Hence, the researcher can conclude that residuals are normally distributed.

6.4 Descriptive statistics

Descriptive analysis is used to present the maximum value, minimum value, standard deviation and mean of the dependent variable and independent variable. Maximum value indicates the highest value of the sample while minimum value states the lowest value of the sample. Standard Deviation shows how data spread from its mean value and mean value shows how the data are situated.

Table: 3 Descriptive Statistics of Variables

Descriptive Statistics	N	Minimum	Maximum	Mean	Std. Deviation
Financial Performance	85	1.00	5.00	2.9941	1.27357
Reporting Practices	85	1.00	5.00	3.1059	1.21739
Management Practices	85	1.25	4.75	3.0676	0.93493
Analysis Practices	85	2.00	4.75	3.2765	0.65012
Inventory Management Practices	85	1.20	4.80	3.0141	0.91015
Valid N (list wise)	85				

(Source – Survey Data, 2018)

Financial performance has a mean value of 2.99 with a maximum of 5.00 and a minimum of 1.00 which lead to a moderate level. Standard deviation of the financial performance, it shows a value of 1.27 which means there is no greater spread in the data, which directs that used data set was effective and or no more errors occurred within because accepted theoretical threshold level of standard deviation should lie in between -3 to +3.Reporting practices vary between 1.00 to 5.00 with the mean and standard deviation value

of 3.11 and 1.21 respectively. The mean value is greater than 3, thus it is highly satisfactory. Standard deviation of reporting practices also within the standard range between -3 to +3. Therefore, the data set of this variable also free from errors.

6.5 Data Presentation

The required data for the study were obtained from the questionnaire. To measure the performance of SMEs the research has used the ROA and Net profit. The researcher will present the data and information collected in the survey.

The majority of the respondents in the sample are accountants and it is a 92% of the sample and the balance is 8% of the samples are owners of the firm.

Table: 4 Type of the Business

Business Type	Frequency	Percent %
Manufacturing	67	78.8
Building and Construction	18	21.2
Total	85	100.0

(Source- Survey Data,2018)

According to table: 4 most of the businesses are in manufacturing sector SMEs in Western province that cover Gampaha, Colombo and Kaluthara districts and it presents 78.8% of the sample. The rest is in the building and construction sector and it presents 21.2% of the sample.

Table: 5 Responded districts in Western province

District	Frequency	Percent %
Gampaha	33	38.8
Colombo	38	44.7
Kaluthara	14	16.5
Total	85	100.0

(Source – Survey Data, 2018)

According to table: 5, the study was selected 38 of SMEs in Colombo district , the balance has represented the SMEs in Gampaha district that present 38.8% and SMEs in Kaluthara that presents 16.5% of the selected sample.

Table: 6 No. of years in operations of the current Business.

No. of years in operations	Frequency	Percent %
1-3	4	4.7
4-7	24	28.2
Above 7	57	67.1
Total	85	100.0

(Source-Survey Data, 2018)

As per the above table, most of the SMEs in the sample is operating for more than seven years with the representation of 67.1% out of the total sample. There are 24 SMEs with the operation years from four to seven that represent 28.2% of the sample and 4 SMEs with the operation years from one to three that represent 4.7% of the sample.

Table: 7 Annual Turnover of the firm.

Annual Turnover	Frequency	Percent %
Less Than 15 Mn	37	43.5
16 – 250 Mn	44	51.8
251 – 750 Mn	4	4.7
Total	85	100.0

(Source-Survey Data, 2018)

SME"s that earns turnover within the range of 16 to 250 Mn has responded than others, according to the table: 7. there are 44 SMEs in western province that represent 52% of the sample. There are 37 SMEs which are earning turnover less than 15 Mn that represent 43 % and 4 SMEs which are earning turnover within the range of 251 to 750 Mn that represent 5% of the sample. The SME policy framework has define SMEs in Sri Lanka as any firm which is earning less than 750 Mn annual turnover and any firm which has less than 300 employees. Therefore, the sample of the study has satisfied the requirement of SME policy framework. There are no existing SMEs which earn more than 750 Mn annual turnover or more than 300 employees. Table: 8 present the no. of employees in SME as follows;

Table: 8 No. of employees of the firm.

Number of Employees	Number of Employees	Percent %
Less than 10	12	14.1
11 – 50	32	37.6
51- 200	37	43.5
201-300	4	4.7
Total	85	100.0

(Source – Survey Data, 2018)

According to table: 8 most of the responded SMEs have 51 to 200 employees, the amount of 37 SMEs that represent 43.5% of the sample. And also there are 12 SMEs which have less than 10 employees that represent 14.1%, 32 SMEs which have 11 to 50 employees that represent 37.6% and 4 SMEs which have 201 to 300 employees out of the sample. These no. of employees in a SME also satisfied the requirements of the SME policy framework.

6.6 Correlation Analysis and Hypothesis testing

The correlation analysis describes the correlation of each variable with other variables including dependent variable. Therefore, the correlation matrix is advantageous to the researcher to identify initially whether there is a relationship with each variable and relationship between each dependent variables and independent variables. Correlation value of -1 represents complete negative relationship while +1 represents a perfect relationship between variable.

6.6.1 Correlation Analysis - Between Financial Reporting Practices and Financial Performance

Table: 9 Correlation Analyses

Correlations		Financial Performance	Financial Reporting Practices
Financial Performance	Pearson Correlation	1	.679**
	Sig. (2-tailed)		.000
	N	85	85

**. Correlation is significant at the 0.01 level (2-tailed).
(Source – Survey Data, 2018)

According to table: 9 Pearson Correlation is 0 679 suggesting that there is a significant relationship between financial reporting practices and financial performance of SME's. Probability of occurring correlation between independent and dependent variable is determined by looking at the level of significance value and it should be less than 0.005 at 95% confidence level to be accepted advanced hypotheses.

Hence correlation coefficient of this study is attained by the significance value of 0.001 at 99% of confidential level. Therefore the founded correlation coefficient is 0.000, statistically significant. Thus, the researcher can accept the Hypothesis (H1A) is that there is a significant relationship between financial reporting practices and financial performance of SMEs.

6.6.2 Correlation Analysis – Between Reporting Practices and Financial Performance

Table: 10 Correlation Analysis

Correlations		Financial Performance	Reporting Practices
Financial Performance	Pearson Correlation	1	.572**
	Sig. (2-tailed)		.000
	N	85	85

**. Correlation is significant at the 0.01 level (2-tailed).
(Source – Survey Data, 2018)

There is a positive relationship between reporting practices and financial performance of SMEs because there is 57% of Correlation between these two variables, according to the above table. And correlation coefficient .000, statistically significant at 5% of significant level to 95% confidence level. Thus, the null hypothesis can be rejected and alternative hypothesis, H2A has to accept, there is a significant relationship between reporting practices and financial performance of SMEs.

6.6.3 Correlation Analysis - Between Management Practices and Financial Performance

Table: 11 Correlation Analysis

Correlations		Financial Performance	Management Practices
Financial Performance	Pearson Correlation	1	.635**
	Sig. (2-tailed)		.000
	N	85	85

**. Correlation is significant at the 0.01 level (2-tailed).

(Source – Survey Data, 2018)

Due to correlation between management practices and financial performance is 63.5%, there is a positive relationship between these two variables. At the 5% of significant level, the correlation coefficient is .000 which significant statistically. Because of that, H3A: there is a significant relationship between management practices and financial performance can be accepted with reject the null hypothesis.

6.6.4 Correlation Analysis - Between Analysis Practices and Financial Performance

Table: 12 Correlation Analysis

Correlations		Financial Performance	Analysis Practices
Financial Performance	Pearson Correlation	1	.363**
	Sig. (2-tailed)		.001
	N	85	85

**. Correlation is significant at the 0.01 level (2-tailed).

(Source – Survey Data, 2018)

There is a 36% of relationship between analysis practices and financial performance of SMEs. Therefore these two variables have poor correlation. At the 5% of significant level, the correlation coefficient is .001 which significant statistically. Therefore, H4A: there is a significant relationship between analysis practices and financial performance can be accepted with reject the H0C

6.6.5 Correlation Analysis - Between Inventory Management Practices and Financial Performance

Table: 13 Correlation Analysis

Correlations		Financial Performance	Inventory Management Practices
Financial Performance	Pearson Correlation	1	.593**
	Sig. (2-tailed)		.000
	N	85	85

**. Correlation is significant at the 0.01 level (2-tailed).

(Source – Survey Data, 2018)

According above to table, the Correlation between inventory management practices and financial performance is 59.3%. Thus, there is a positive relationship between these two variables. And correlation coefficient .000, statistically significant at 5% of significant level with 95% confidence level. Thus, the null hypothesis (H5) can be rejected and alternative hypothesis, H5A: has to accept, there is a significant relationship between inventory management practices and financial performance of SMEs.

6.7 Test of Multicollinearity

Multicollinearity is a high inter correlations or high inter-associations among the independent variables. There is a multicollinearity, if there are more than 0.7 of Pearson correlation values between each independent variables In this study correlation analysis and variance inflation factor has used to find out the relationship between independent variables such reporting practices, management practices, analysis practices and inventory management practices. The results obtained from the statistical analysis are presented in following correlation table.

Table: 14 Correlation Matrix for Multicollinearity

Correlations		Financial Performance	Reporting Practices	Management Practices	Analysis Practices	Inventory Management Practices
Financial Performance	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	85				
Reporting Practices	Pearson Correlation	.572**	1			
	Sig. (2-tailed)	0				
	N	85	85			
Management Practices	Pearson Correlation	.635**	.523**	1		
	Sig. (2-tailed)	0	0			
	N	85	85	85		
Analysis Practices	Pearson Correlation	.363**	.502**	.501**	1	
	Sig. (2-tailed)	0.001	0	0		
	N	85	85	85	85	
Inventory Management Practices	Pearson Correlation	.593**	.577**	.649**	.567**	1
	Sig. (2-tailed)	0	0	0	0	
	N	85	85	85	85	85

**. Correlation is significant at the 0.01 level (2-tailed).

(Source – Survey Data, 2018)

According to the table: 14 all Pearson correlation values between each independent variables are less than 0.7. Thus, there is no Multicollinearity between independent variables in this study.

According to the below table all the VIF values are lesser than 10. So that it can be concluded that there is no perfect multicollinearity between each independent variables.

Table: 15 VIF values to test Multicollinearity

Model	Unstandardized Coefficients		Collinearity Statistics	
	B	Std. Error	Tolerance	VIF
(Constant)	.146	.520		
Reporting Practices	.301	.106	.598	1.672
Management Practices	.524	.146	.532	1.880
Analysis Practices	-.214	.195	.617	1.621
Inventory Management Practices	.335	.161	.461	2.167

(Source – Survey Data, 2018)

6.8 Model Estimation

Result of regression model - Impact of Financial Reporting Practices on Financial Performance of SMEs in Western province, Sri Lanka.

In this study, the researcher conducted a multiple regression analysis to test the impact among predictor variables. The research used SPSS 23 to enter data and compute the measurements of the multiple regressions. Likert scale questions were quantified through SPSS and run the multiple regression analysis on the relationship between financial reporting practices and financial performance of small and medium enterprises in Sri Lanka.

Table: 16 Regression Result Output

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.146	.520		.280	.780
Reporting Practices	.301	.106	.287	2.841	.006
Management Practices	.524	.146	.384	3.585	.001
Analysis Practices	-.214	.195	-.109	-1.097	.276
Inventory Management Practices	.335	.161	.239	2.078	.041

(Source – Survey Data, 2018)

Based on the coefficient values in the table: 16, the regression equation of the financial performance can be constructed as follows;

$$Y = \beta 0 + \beta 1RP + \beta 2MP + \beta 3AP + \beta 4IMP + \varepsilon$$

Where,

Y = Financial performance of SMEs which is measured by the return on assets and net profits of the firm.

RP = Reporting Practices

AP = Analysis Practices

MP = Management Practices

IMP = Inventory management System

ε = error term

$$Y = 0.146 + 0.301RP + 0.524MP - 0.214AP + 0.335IMP + \varepsilon$$

According to the above stated equation when reporting practices, management practices, analysis practices and inventory management practices are zero the autonomous level of financial performance is 0.146 which means that there are other factors having an influence on the financial performance of SMEs as well.

A unit increase in reporting practices would lead to increase 30.1% of financial performance, a unit increase in management practices would lead to increase in amount of financial performance by 52.4% of units, a unit increase in analysis practices would lead to decrease the financial performance of SMEs by 21.4%, a unit increase in inventory management practices would lead to increase in financial performance of SMEs by a factor of 33.5% of units. Thus, there is a positive impact of reporting practices, management practices and inventory management practices and a negative impact of analysis practices on the financial performance of SMEs in Western province, Sri Lanka.

Model Summary[b]

Table: 17 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.715[a]	.511	.486	.91293	1.639

a. Predictors: (Constant), Inventory Management Practices, Analysis Practices, Reporting Practices, Management Practices

b. Dependent Variable: Financial Performance

(Source – Survey Data, 2018)

Generally the R2 value of the model tells that the goodness of fit in the model. In this model multiple R2 value is 51.1% (Adjusted R2 value is 48.6%) which indicates that a 51.1% of variation in the financial performance is explained by the combination of independent variables. Therefore, these research findings conclude that financial reporting practices can use as the proxies for the financial performance of SMEs in Western province, Sri Lanka and to measure its impact on firm performance of SMEs.

ANOVA[a]

Table: 18 ANOVA table

Model	Sum of Squares	Df	Mean Square	F	Sig.
Regression	69.572	4	17.393	20.869	.000[b]
Residual	66.675	80	.833		
Total	136.247	84			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Inventory Management Practices, Analysis Practices, Reporting Practices, Management Practices

(Source – Survey Data, 2018)

By looking at the F-statistics and corresponding probability value it can be used as a proxy for checking overall model significance. In this model F-value is 20.869 and corresponding probability value is 0.000 which is less than 0.05, meaning that that overall model is significant at 1%. If the f-statistics are significant, it indicates that Independent variables (RP, MP, AP and IMP) jointly can influence to dependent variable which is the financial performance of SMEs .This is a good sign for the model. When considering the individual independent variable reporting practices, management practices and inventory management practices significant in explaining financial performance at 5%. Analysis practices is insignificant. So that researcher can conclude that more than 50% of the variables are significant in explaining financial performance of SMEs.

6.9 Discussion of the findings

The study has concluded that there is a significant relationship between financial reporting practices such as reporting practices, management practices, analysis practices and inventory management practices and financial performance of SMEs in Western province, Sri Lanka. Pearson correlations 0.679 suggesting that there is a significant relationship between financial reporting practices and financial performance of SMEs. The founded correlation coefficient is 0.000, statistically significant at 5% of significant level.

Further, it is separately analyzed the correlation coefficient of the sub division of financial reporting practices on the conceptual framework. There is a positive relationship between reporting practices and financial performance of SMEs because there is 57% of Correlation between these two variables. And correlation coefficient .000, statistically significant at 5% of significant level to 95% confidence level.

And also the Correlation between management practices and financial performance is 63.5%. Thus, there is a positive relationship between these two variables. At the 5% of significant level, the correlation coefficient is .000 which significant statistically. There is a 36% of poor relationship between analysis practices and financial performance of SMEs. At the 5% of significant level, the correlation coefficient is .001 which significant statistically. Finally inventory management practices and financial performance has 59.3% of positive relationship.

There is a 51.1% of variation in the financial performance is explained by the combination of independent variables because multiple R2 value is 51.1% (Adjusted R2 value is 48.6%) of the study. Reporting practices, management practices and inventory management practices significant in explaining financial performance at 5%. Analysis practices is insignificant. Therefore, the researcher can conclude that more than 50% of the variables are significant in explaining financial performance of SMEs.

Muinde (2013) also has found that there is a strong positive relationship between financial reporting, financial analysis, financial management and management accounting and financial performance of SMEs in Kenya. And also the study has found that a unit increase in financial reporting practices leads to increase in financial performance of SMEs. Rathnasiri (2014) has done a same research that relating to financial reporting practices and financial performance of SMEs and this researcher also concluded that majority of SMEs in Sri Lankan pay an attention to prepared financial statements such as statement of financial position, income statement and the cash flow statement to meet day today operation requirements and fulfillment of financing purposes, not for the purpose of fulfilling statutory requirement.

Karunananda & Jayamaha also studied about Financial Practices and Performance of SME in Sri Lanka. The researcher concluded that financial practices are more comprehensive in SMEs with the concerns in asset value terms. There is a statistically difference between SMEs, with the practices are more extensive in SMEs concern. The comprehensiveness of the financial practices are statistically greater that performing strongly in sales revenue terms. Further the result concluded that SMEs who following proper financial reporting practices are performing well than who are not. There is a significant impact of financial practices on business performance of SMEs in Sri Lanka. Chakrapani (2015) also attempted to analyze Financial Reporting and its impact on Growth and Performance of Indian Manufacturing SME's. This researcher has found that financial reporting practices are more comprehensive in employment terms and there are significant differences in the comprehensiveness of financial reporting practices exists between SMEs.

This research demonstrated that there is a high importance on the preparation and monitoring the financial statements of the businesses which is essential to the success of the business and the survival in the industry. But there is a significant portion of SMEs in Western province, Sri Lanka kept inadequate financial records and maintained inappropriate financial reporting practices and informal accounting system. These types of SMEs have to face many difficulties to survive in the industry and they cannot obtain funds and borrowings from bank and other financial institutions easily. (Kofi, et al., 2014) also found that most of SMEs don't prepare financial reports, and have poor records keeping because fear to publish information to the public, have to incur high cost for financial reporting and lack of education regarding the importance of financial reporting. Therefore, SMEs have failed in access financial assistance from the government and the private institutes.

But McMohan (1995) has found that there is a statistically significant difference in the comprehensiveness of the financial reporting practices exists among small enterprises and medium-sized enterprises and the comprehensiveness of the financial reporting practices seems to be statistically unrelated to the profitability. The study concluded that financial reporting practices have a minor

influence on some growth and performance outcomes. And also (Kitonga, 2013) has found that the financial management practices are positively impacted on the financial performance, but not all the financial management practices which are employed involve to enhance the financial performance in every industries irrespective the nature of the commercial activities.

6.10 Summary

Overall of this chapter it comprises the summarization of analyzed data collected from the survey. Through this chapter it states the study of Validity & Reliability, Descriptive Statistics of Variables, Correlation, and Regression and provide the relevant explanations with statistical data and the study found that there is a significant relationship between reporting practices, management practices, analysis practices and inventory management practices and financial performance of SMEs.

In the later part of the chapter, it was highlighted the major differences and similarities from the literature or between different groups. As well as explained the reasons and significance behind features or decisions being discussed by using similar studies.

7. Conclusion

The finding demonstrated that most of SMEs pay more attention in preparation and monitoring financial statements there is a high importance on the preparation and monitoring the cash flows of the businesses. But there is a significant portion of SMEs in Western province, Sri Lanka kept inadequate financial records and maintained inappropriate financial reporting practices and informal accounting system. Because of this SMEs have to face many difficulties and staff in SMEs to keep financial records properly And significant no. of SMEs have computer based software in recording transactions.

SMEs used ratios to analyze the financial statements and compared with previous years and other same businesses which are in the same industry And also most of SMEs use internally generated cash to operate the business and they cannot obtain funds and borrowings from bank and other financial institutions easily.

Most of SMEs use inventory management practices such as periodic inventory count and maintain physical safeguards of inventory against theft. SMEs determined inventory level based on the owner's experience and use standard cost to estimate the value of inventory.

There is a significant relationship between financial reporting practices and the financial performance SMEs who adopting appropriate financial reporting practices are perform well than who are not adopting with them.

8. References

Abanis, T. et al. (2013) 'Financial Management Practices In Small and Medium Enterprises in Selected Districts in Western Uganda', *Research Journal of Finance and Accounting*, 4(2), pp. 2222–2847. doi: 10.5897/AJBM2013.6899.

Capon, N., Farley, J. U. and Hoenig, S. (1990) 'Determinants of Financial Performance : A Meta-Analysis Author (s): Noel Capon, John U. Farley and Scott Hoeing Source : Management Science, Vol . 36, No. 10, Focused Issue on the State of the Art in Theory and Method in Strategy Research (Oct.', Management Science, 36(10), pp. 1143–1159. Available at: http://www.jstor.org/stable/2632657.

Goodwin, J. and Ahmed, K. (2006) 'The impact of international financial reporting standards: does size matter?' *Managerial Auditing Journal*, 21(5), pp. 460–475. doi: 10.1108/02686900610667247.

Jennifer, K. M. and Dennis, O. (2015) 'Financial Management Practices on growth of Small and Medium Enterprises: A case of Manufacturing Enterprises in Nairobi County', *IOSR Journal of Business and Management Ver*. II, 17(8), pp. 2319–7668. doi: 10.9790/487X-17826577.

McMahon, R. G. P. (2001) 'Business Growth and Performance and the Financial Reporting Practices of Australian Manufacturing SMEs*', *Journal of Small Business Management*, 39(2), pp. 152–164. doi: 10.1111/1540-627X.00014.

Muinde, C. (2013) 'Relationship between Financial Reporting and Analysis Practices and Financial Performance of Small and Medium Enterprises in Kenya', *International Journal for Management Science and Technology*, 2(3), pp. 30–35.

Olatunji, T. E. (2011) 'the Impact of Accounting System on the Performance of Small and Medium Scale Enterprises in Nigeria – A Survey Of SME In Oyo State-Nigeria', *International Journal of Business and Management Invention*, 2(9), pp. 13–17. doi: 10.15640/smq.v3n1a3.

Ramadas, T. and Satish, K. P. (2018) 'Identification and modeling of employee barriers while implementing lean manufacturing in small- and medium-scale enterprises', *International Journal of Productivity and Performance Management*, 67(3), pp. 467–486. doi: 10.1108/IJPPM-10-2016-0218.

Studies, M. (2015) 'the Financial Management Practices of Small and Medium Enterprises in Sri Lanka', pp. 374–399. Vohra, P. S. and Dhillon, J. S. (2014) 'Best Financial Practices Lead Financial Performance of Smes', *International Journal of Accounting and Financial Management Research*, 4(3), pp. 5–16.