

The Impact of Accounting Principles on Managerial Decision-Making in Small and Medium Enterprises

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Abstract

Effective accounting practices are crucial for the strategic management of small and medium enterprises (SMEs). Yet, many lack essential financial frameworks such as fixed asset registers, cash flow statements, and budgets. This oversight hampers informed decision-making, as management often sets targets without adequate information regarding the costs and benefits of various choices. The paper explores the foundational accounting principles that underpin sound financial reporting, which include Generally Accepted Accounting Principles (GAAP), and their influence on managerial decisions in SMEs. It examines the pivotal role that accounting data plays in guiding operational and long-term strategic planning, offering insights into how accurate financial statements driven by adherence to accounting principles can enhance operational efficiency and performance. Furthermore, non-financial indicators are discussed as they serve as crucial determinants of future financial success. The analysis illustrates how the absence of robust financial reporting can leave managers ill-equipped to navigate strategic directions, emphasizing the importance of integrating accounting practices into the decision-making processes. Ultimately, the research highlights the strategic relevance of accounting in SMEs, demonstrating how it supports the achievement of broader organizational objectives through more informed and reliable management practices.

Keywords: Accounting Principles - Managerial Decision Making - Small and medium Enterprises

1. Introduction

Small and medium enterprises (SMEs) generally lack a fixed asset register, do not prepare a cash flow statement, fail to forecast cash flows, and rarely set budgets (Terfasa Dinka, 2019). Consequently, management sets targets without adequate information on the costs or benefits of alternative routes to desired objectives. Despite the widespread awareness of the importance of accounting in supporting the management process, it is frequently overlooked in practice, even by those responsible for managing the business. For a sector of such importance, considerable scope exists for new insights concerning the use of accounting information (Abu Mater & Kanasro, 2018).

2. Overview of Accounting Principles

Accounting principles are the rules and methods that companies follow when preparing their financial statements and records (Terfasa Dinka, 2019). They provide a framework for measuring, recording, and presenting the gross-profit, net-profit, assets, liabilities, income, and expenses of an organization and constitute the foundation of attractive financial reports (Lasdi & Winda Mulia, 2014). When consistently applied with objectivity, prudence, and unpopular opinion evaluations, accounting principles ensure the provision of more informative data that have greater forecasting and decision-making value, enable longitudinal comparisons of financial statements, and facilitate a better understanding of organizational operations. Curiously, although several accounting principles and standards exist, no research has specifically investigated which of them is the most useful for managerial decision-making in small and medium enterprises.

Types of accounting principles include the Historical Cost Principle, Revenue Recognition Principle, Consistency Principle, Going Concern Principle, Matching Principle, and Full Disclosure Principle. The Historical Cost Principle requires asset values to be recorded, analyzed, and reported at their acquisition cost rather than their current market value. The Revenue Recognition Principle clarifies when companies should recognize revenue; for instance, in the case of installment sales, some organizations improperly record the entire amount immediately upon commitment, whereas another suggests recognizing revenue only when cash is received. The Consistency Principle advocates for the use of the same accounting methods across periods; changing methods diverts attention from a company's true performance. The Going Concern Principle presumes that an entity will not be liquidated but instead continue to exist and operate as intended. The Matching Principle demands that

expenses be matched with the revenues they generate and recognized in the same period. The Full Disclosure Principle warns that a company should pro-actively provide sufficient information that can influence the decisions and judgments of outsiders. (Tran, Truong, Vu, & Nguyen, 2023)

2.1. Definition and Importance

Accounting principles are the foundational guidelines that govern the preparation and presentation of financial information. They serve as the building blocks for financial statements, enabling stakeholders to make informed, consistent, and comparable decisions about a company's financial status (Lasdi & Winda Mulia, 2014). For accounting information to be useful, managers typically rely on a comprehensive set of accepted accounting principles (Yousef AL Smirat, 2013).

There are several widely recognized accounting principles and related concepts, including: entity, going concern, matching, consistency, unit of measure, conservatism, materiality, full disclosure, cost, revenue recognition, time period, and monetary unit principles. Among these, the Generally Accepted Accounting Principles (GAAP) are the dominant accounting standards for preparing financial statements, specifying the accounting techniques and procedures that organizations should employ.

2.2. Types of Accounting Principles

Accounting convention refers to a belief and a common set of rules, procedures, and practices, which guide accountants in selecting from the reasonable alternatives available and in deciding the format and content of financial statement (Terfasa Dinka, 2019). A principle is an accepted fundamental truth that provides a basis for consistency in accounting system and procedures. Accounting principles serve as the bases for financial accounting standards and are intended to guide accountants in recording and reporting financial activities.

Accounting principles are widely used guidelines that companies use to compile and report their financial statements. These guidelines ensure that the statements are consistent and comparable. Accounting principles are broken down into three sub-classes. These are general principles, assumptions, and constraints. Each of these sub-classes encompasses several accounting concepts that the accountants need to be aware of and follow to the letter.

3. Managerial Decision-Making Process

The process of making managerial decisions has attracted the interest of researchers, particularly when focusing on the factors that influence the role of accounting information in organizations. The literature has identified a number of decision-making theories, which organize different decisions attempting the use of accounting information (Kengne, 2015). Among the various theories, Simon's business decision-making process has been used to highlight the managerial decision-making process in small and medium enterprises (SMEs). According to Simon's model, three stages characterize the decision-making process: intelligence, design, and choice. These stages materialize through different decisions made by the manager.

In SMEs, managers make quick financial decisions by focusing on short-term factors such as costs and cash flows, and techniques including budgeting, cost-volume-profit analysis, and variance analysis. In the design stage, managers consider accounting information and process the retrieved information to develop various alternatives, followed by identifying the organizational problem and developing feasible solutions. During the choice stage, managers choose the most appropriate solution aligned with organizational objectives. Accounting contributes mainly in the intelligence and design stages (Abu Mater & Kanasro, 2018).

3.1. Understanding Decision-Making

Managerial decision-making involves choosing a course of action from various options to achieve organizational objectives. Research indicates that managers, including owner-managers, engage continuously in decision-making throughout their work activities (Kengne, 2015). The decision-making process includes several stages: problem identification, consideration of alternative solutions, evaluation of alternatives, selection and implementation of the preferred option, and ongoing monitoring and control of outcomes.

According to, successful decision-making depends on the human decision maker's ability to search for and analyze information while considering relevant factors and environmental influences. Information gathering strategies can be either active or passive, utilizing internal sources such as personal judgment and external sources like advice from others, meetings, courses, journals, and the internet. In small and medium enterprises, consideration of financial information may be formal, involving written, rational tools, or informal, based on intuition and pattern recognition (Abu Mater & Kanasro, 2018). Non-financial factors—including personal ambitions, social responsibility, and environmental concerns—also play a role. Feedback

mechanisms are integral to the process, enabling evaluation and control through continuous observation, monitoring, and follow-up.

3.2. Factors Influencing Decisions

Decision-making is a multifaceted process encompassing identification of the dilemma, development of alternatives, data collection and evaluation, selection among options, implementation, and feedback evaluation. It entails choosing between alternatives or accepting the status quo by methodically appraising expected consequences. Numerous elements shape managerial decisions, among which accounting occupies a pivotal role in small and medium enterprises (SMEs). (Silaen & Tulig, 2023)

Decision-making theories regard individuals as rational actors striving to select the best possible outcomes; yet, other factors often sway choices. The attitude-behavior relationship within organizational contexts exemplifies how various social-psychological variables influence decisions, especially by affecting the involvement in the process. Managers in SMEs rely on a wide array of information, encompassing financial and non-financial data. They employ diverse decision-making criteria such as optimality, sufficiency, consensus, or satisfaction and act based on a combination of quantitative and qualitative inputs, particularly when confronted with complex tasks. (Ombai, Kiflemariam, & Odollo, 2024)

The significance of accounting in management is affirmed by its linkage to cost accounting systems; nonetheless, comprehensive utilization to the extent to which managerial accounting techniques inform decisions warrants further examination, particularly in the SME sector. Accounting serves as a cornerstone of management practices, essential for problem-solving, strategic formulation, operational control, and formative assessment. Managers depend heavily on accounting information for planning, budgeting, forecasting, short-term operational management, and overall performance measurement. It elucidates scenarios, clarifies events, and underpins critical business decisions at both tactical and strategic levels. In SMEs, the informational load is often substantial relative to managerial capacity, predominantly focusing on fiscal considerations, thereby imbuing accounting data with paramount importance when rhetorical and other forms of evidence are lacking. (Abu Mater & Kanasro, 2018); (Kengne, 2015); (Lasdi & Winda Mulia, 2014)

4. Role of Accounting in SMEs

Accounting provides information necessary for effective operational and strategic management decisions (Mohamad & Abd. Wahab, 2017). SMEs rely on accounting to derive essential information for short-term revenue, expenditure, and cash-flow management.

Financial reporting is fundamental to accounting; it organises input data into meaningful transactions to measure financial position and performance, assisting in resource allocation (Lasdi & Winda Mulia, 2014). Preparations include a trading account, profit and loss account, and balance sheet, grounded in accounting principles to guide material, prudent, and consistent reporting. SMEs require accounting principles to generate reports aligned with principles, thereby aiding timely, accurate, and reliable decision-making.

SMEs also apply accounting in budgets and forecasts. Preparing budgets involves estimating revenues and expenditures to arrive at sales budgets and profit targets. Accurate forecasting and budgeting are vital data sources that directly affect financial accounts. Additionally, accounting enhances analytical practices in evaluation, control, and performance measurement, leading to the employment of relevant performance indicators. The resulting accounting reports enable SMEs to identify operational inefficiencies and financial shortcomings promptly. (Okeke, Bakare, & Achumie, 2024)

The exchange of information through accounting facilitates managerial processes by consolidating internal and external business data. A well-designed accounting system therefore significantly improves the quality of managerial decisions.

4.1. Financial Reporting

Financial reporting represents a vital element within the spectrum of accounting functions. It entails the preparation and transmission of financial data pertaining to the internal operations of an organization. The procedure involves a comprehensive compilation of the company's income and expenditure, its claims to and on resources, and the resultant effects on its financial position. Within small and medium enterprises (SMEs), financial reports provide the foundation for broader accounting analyses. The determination of a firm's profit or loss necessitates the preparation of a profit and loss account. This encompasses the calculation of all expenditure and charges attributable to the accounting period, thereby revealing a residual net figure representing profits or losses. Crucially, this exercise encompasses the shared obligations of management and the owner(s) alike. In parallel, the assessment of the company's assets requires the preparation of a balance sheet, where those entitled to a share take precedence over

the providers of capital (Terfasa Dinka, 2019). The resultant balance facilitates the calculation of the return on capital employed, thereby supporting further examination of all gains and losses and their relationship to the volume of business operations.

4.2. Budgeting and Forecasting

Budgeting and forecasting are fundamental managerial tasks within small and medium enterprises that define objectives, allocate resources, and measure performance against the plan (Mulani, Chi, & Yang, 2015). A budget establishes expected income and expenses, serving as a comprehensive financial expression of the business plan (Putri Larasati, Sri Andayani, Laily, & Kholilah, 2017). Forecasts are derived from these budgets and guided by the business plan, yet they are not strictly tied to the current budget period; fluctuations in the business environment necessitate tactics that dynamically adjust short-term trends and plans. Because budgets are founded on assumptions, considerable effort is dedicated to anticipating potential precipitation of these conditions. Proper forecasting supports long-term planning; it links short-term operational actions with long-term strategic financial considerations for the firm by tracking performance and predicting future financial performance based on the contemporary economic, business, and market environment. (Matsoso, Nyathi, & Nakpodia, 2021)

4.3. Performance Measurement

Small and medium enterprises (SMEs) play an important role in the economy, but they also have a relatively high failure rate. Poor management has often been cited for this failure (Chidinma Maduekwe & Kamala, 2016). A significant amount of the literature has been devoted to measures of performance, since performance measurement is fundamental to the understanding and development of the management practices necessary to improve performance. Yet many researchers believe the use of inappropriate performance measures accounts for much of this failure.

The most commonly used measures are financial, usually those included in published accounts. However, financial measures focus management attention on past results rather than the determinants of success, which are the non-financial drivers that generate long-term profitability. Moreover, financial measures provide only lagging information about the organisation, describing what has gone wrong but offering little assistance to the manager in preventing or improving future performance. Decision-makers often receive incomplete information about what is happening in the business and the factors influencing performance,

resulting in uncoordinated or ineffective actions and damage to long-term performance. (Mio, Costantini, & Panfilo, 2022)

Furthermore, financial measures usually fail to reflect the organisation's strategic objectives. They have relatively little explanatory power in terms of the causes of business success and represent only a limited part of overall performance. Financial measures often promote short-termism and risk to the sustainability of the organisation. Non-financial indicators, on the other hand, are regarded as the key to superior performance and a better predictor of future financial success. Consequently, non-financial measures have received increased attention and have been widely adopted by business organisations to assess and control their performance. (Zarzycka & Krasodomska, 2022)

5. Exploring the Relevance of GAAP in Strategic Decisions

Small and medium enterprises (SMEs) are often established with common strategic objectives, such as the pursuit of profit, growth, and growth sustainability (J. Berry, Sweeting, Goto, & Taylor, 2022). Managers start with a strategic vision of success and proactively seek the information necessary to enable effective planning and decision-making to realize this vision. Accounting principles, upheld throughout the accounting cycle, assist managers by providing information that supports the achievement of organizational goals.

One recognized set of accounting principles, widely regarded as industry best practice and applied by fortytwo percent of SMEs surveyed, is generally accepted accounting principles (GAAP) (Terfasa Dinka, 2019). GAAP thus warrants particular attention. Researchers have concluded that strategic decisions determine the long-term direction of an organization, which underscores the importance of understanding the impact of GAAP on managerial decision-making. Consistent application of GAAP requires adherence to the full set of principles without arbitrary acceptance or rejection. Accordingly, managers informed by GAAP will utilize all eight underlying accounting principles in their decision-making processes.

6. The Role of Financial Statements in Operational Planning

Financial statements play an essential role in operational planning. Because successful business management depends on accurate and consistent data, sound financial information provides the foundation for appropriate policies and decisions. Basic financial statements including income statements, balance sheets, and capital statements must be prepared at appropriate

intervals in order to assist management in short term planning decisions. Yet accurate and complete financial statements cannot be compiled without the application of appropriate accounting principles. For this reason, financial statements link operational planning with accounting principles (Terfasa Dinka, 2019).

A number of accounting principles influence the preparation of financial statements. Among the most significant are the Matching Principle, the Revenue Recognition Principle, and the Full Disclosure Principle. The Matching Principle requires costs incurred during a period to be identified and charged against the income of that same period. The Revenue Recognition Principle recognizes revenue in the accounting records of the earnings process rather than when the cash is received. The Full Disclosure Principle requires all significant information to be properly recorded and reported in the financial statements. (Kuntadi, Juwanto, & Zakaria, 2023)

Financial statements are therefore a direct outgrowth of underlying accounting principles. They provide a periodic report of data that can be used for both long and short term planning. As the end products of the accounting process, financial statements represent the final link in the lengthy chain by which accounting principles ultimately influence the conduct of every undertaking.

7. Conclusion

The formulation and implementation of effective business plans have become indispensable in the turbulent contemporary business environment. Financial statements constitute vital instruments that assist managers in devising strategies by facilitating the achievement of strategic objectives (Terfasa Dinka, 2019). Following this rationale, accounting principles serve as the fundamental guidelines underpinning the preparation of financial statements that support SMEs in planning and operational activities (Abu Mater & Kanasro, 2018). The influence of accounting and by extension accounting principles, encompassing GAAP, extends beyond the preparation of financial reports to strategic decision-making in SMEs, which in turn shapes operational plans and enhances planning capability.

The study adopts a qualitative approach utilizing existing literature to identify the impact of accounting principles on managerial decisions. Analysis is organized into sectors corresponding to the study's objectives, with content presented and reviewed accordingly. The absence of comprehensive financial statements leaves managers ill-equipped to develop both strategic and operational plans. Accounting principles provide the foundation for financial-statement

preparation; accordingly, those applicable to SMEs empower managers to devise strategies that address usually limited resources and a multiplicity of obligations.

A coherent set of objectives, policies, and procedures also emerges as a prerequisite for producing information that assists managers in decision-making, monitoring, and control from the viewpoint of both external users and the organization itself. Small enterprises often articulate clearly defined goals, policies, and procedures, whereas their larger counterparts lack such explicitness and frequently resort to elaborate controls systems derived from estimates and assumptions. At this level, accounting principles pertaining to assets and liabilities impose necessary constraints, and at the initial stage, they further support the budgeting process—a fundamental financial-planning element frequently neglected by SMEs—and contribute to the development of forecasting techniques. The undoubted potential of accounting principles to influence managerial decisions clearly demonstrates their strategic relevance within SME interviewees' operational environment.

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