



Original Article

**ACCOUNTING PRACTICES FOR MICRO, SMALL AND MEDIUM ENTERPRISES
(MSMEs)**

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Introduction:

Micro, Small and Medium Enterprises (MSMEs) form the backbone of economic activity in developing economies. In India, the MSME sector plays a decisive role in supporting economic growth by contributing significantly to gross domestic product, employment generation, export promotion, and balanced regional development. These enterprises operate across manufacturing, trading, and service sectors, enabling inclusive growth and encouraging entrepreneurship at the grassroots level. MSMEs also help reduce regional imbalances by creating employment opportunities in semi-urban and rural areas.

Despite their economic importance, MSMEs face numerous challenges that affect their sustainability and growth. Among these challenges, ineffective financial management remains one of the most critical concerns. Many MSMEs operate without formal accounting systems or rely on incomplete financial records, which restrict their ability to assess performance and manage resources efficiently. Weak accounting practices often result in poor cash flow control, inaccurate profit measurement, and non-compliance with statutory requirements.

Accounting is not merely a mechanism for meeting legal obligations; it is a powerful managerial tool that supports planning, control, and evaluation of business operations. Proper accounting practices enable enterprises to analyze financial performance, monitor expenses, maintain liquidity, and plan future activities. Reliable accounting information also enhances transparency and accountability, thereby strengthening relationships with stakeholders such as banks, investors, suppliers, customers, and government authorities. However, due to limited financial resources, lack of accounting knowledge, and dependence on informal practices, many MSMEs fail to adopt sound accounting systems.

This article examines the accounting practices followed by MSMEs, analyzes their importance, identifies major challenges, and suggests measures to strengthen financial management within the MSME sector.

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Objectives of the Study:

Following are the objectives:

1. To explain the concept and importance of accounting practices in MSMEs
2. To examine the accounting systems commonly adopted by MSMEs
3. To identify the major challenges faced by MSMEs in maintaining proper accounting records
4. To analyze the role of accounting in financial control, statutory compliance, and managerial decision-making
5. To suggest practical measures for improving accounting practices in MSMEs

Research Methodology:

The study is based on a descriptive and analytical research design. It relies primarily on secondary data collected from academic journals, published research articles, government reports, MSME policy documents, accounting standards, textbooks, and professional publications. In addition, observational insights derived from practical exposure to MSME accounting environments have been incorporated to enhance the relevance of the study. The analysis is qualitative in nature and focuses on identifying prevailing accounting practices, key challenges, and suitable improvement strategies for MSMEs.

Concept of MSMEs:

Micro, Small and Medium Enterprises are defined and classified according to prescribed thresholds of investment in plant and machinery and annual turnover, as notified by regulatory authorities. These enterprises generally operate on a limited scale and are established with modest capital investment. MSMEs are typically owner-managed, with decision-making authority concentrated in the hands of proprietors or partners, which directly influences operational and financial practices.

Due to their size and structure, MSMEs face higher levels of operational uncertainty and financial vulnerability compared to large corporations. Market fluctuations, limited access to institutional credit, dependence on short-term funds, and intense competition increase their exposure to risk. As a result, MSMEs require accounting systems that are simple, flexible, and cost-effective while still providing reliable financial information.

Unlike large organizations that maintain dedicated finance and accounting departments, MSMEs often rely on basic accounting arrangements managed by owners, clerical staff, or outsourced professionals. Therefore, accounting practices suitable for MSMEs must balance simplicity with accuracy, enabling enterprises to meet statutory requirements and managerial needs without imposing excessive administrative burdens.

Importance of Accounting Practices for MSMEs

Financial Control:

Accounting plays a vital role in maintaining financial discipline within MSMEs. Systematic recording of transactions allows enterprises to monitor expenses, regulate costs, and prevent misuse of funds. Proper bookkeeping ensures that financial resources are utilized efficiently and helps detect irregularities at an early stage.

Cash Flow Management:

Liquidity management is a major concern for MSMEs, as many operate with limited working capital. Accounting records assist in tracking cash inflows and outflows, outstanding receivables, payables, and inventory levels. Effective cash flow monitoring helps enterprises meet payment obligations and avoid liquidity shortages.

Managerial Decision-Making:

Accurate accounting information supports informed managerial decision-making. Financial



data assists MSME owners in pricing products, controlling costs, preparing budgets, planning expansion, and evaluating investment opportunities. Without reliable accounting records, decisions are often based on intuition rather than evidence.

Statutory and Regulatory Compliance:

MSMEs are required to comply with various legal provisions such as income tax, GST, TDS, and labor regulations. A well-organized accounting system ensures timely and accurate compliance, thereby reducing the risk of penalties, interest, and legal disputes.

Access to Credit and Finance:

Financial institutions depend on accounting records to assess the creditworthiness of enterprises. Properly prepared financial statements enhance the credibility of MSMEs and improve their ability to obtain loans, overdrafts, and other financial assistance.

Measurement of Business Performance

Accounting enables MSMEs to evaluate profitability, efficiency, and growth trends through financial statements such as the Profit and Loss Account and Balance Sheet. Performance analysis supports strategic planning and long-term sustainability.

Accounting Practices Commonly Adopted by MSMEs:

Bookkeeping Systems:

Most MSMEs maintain basic accounting records, including cash books, bank books, sales registers, purchase registers, and expense records. Smaller enterprises often use simplified bookkeeping systems such as single-entry or basic double-entry methods depending on the scale of operations.

Basis of Accounting:

MSMEs generally adopt either the cash basis or accrual basis of accounting. Under the accrual basis, income and expenses are recognized

when they occur. Micro enterprises usually prefer the cash basis due to its simplicity.

Use of Accounting Software:

With increasing digitalization, many MSMEs have adopted accounting software such as Tally, Busy, Zoho Books, and spreadsheet-based systems. These tools facilitate transaction recording, invoice generation, and statutory compliance while reducing manual effort.

Preparation of Financial Statements:

MSMEs prepare financial statements such as Trading Accounts, Profit and Loss Accounts, and Balance Sheets. In many cases, these statements are prepared primarily for taxation or loan purposes rather than for internal financial analysis.

Tax-Oriented Accounting:

Tax compliance significantly influences accounting practices in MSMEs. Enterprises maintain records related to GST input and output credits, income tax computation, and TDS obligations. Tax requirements often determine the structure and frequency of accounting activities.

Inventory Management:

Manufacturing and trading MSMEs maintain inventory records to track raw materials, work-in-progress, and finished goods. However, inventory valuation practices may not always strictly follow standard accounting principles.

Challenges in MSME Accounting Practices:

Limited Accounting Knowledge:

Many MSME owners lack formal training in accounting, resulting in inaccurate record-keeping and excessive dependence on external accountants.

Resource Constraints:

Financial limitations restrict the ability of MSMEs to hire qualified accounting professionals or invest in advanced accounting systems.



Informal Business Practices:

Partial involvement in informal transactions leads to incomplete or inconsistent accounting records, reducing transparency and reliability.

Compliance Complexity:

Frequent changes in tax laws and reporting requirements increase the compliance burden and complicate accounting processes for MSMEs.

Poor Documentation:

Inadequate maintenance of bills, invoices, and vouchers adversely affects the accuracy and reliability of accounting records.

Dependence on Outsourced Accountants:

Outsourcing accounting functions often delays access to financial information and weakens internal financial control mechanisms.

Role of Accounting Standards in MSMEs:

Accounting standards promote consistency, transparency, and comparability in financial reporting. Although comprehensive standards may be complex for MSMEs, adherence to fundamental principles such as consistency, prudence, and the matching concept improves the reliability of financial statements. Simplified accounting frameworks help MSMEs enhance reporting quality without imposing excessive compliance costs.

Impact of Technology on MSME Accounting:

Technological advancements have significantly transformed accounting practices in MSMEs. Automation of bookkeeping and billing processes reduces manual workload and improves accuracy. Digital tools simplify GST and tax compliance by enabling real-time calculations and timely return filing. Access to real-time financial information allows MSME owners to monitor performance and make informed decisions. Technology also minimizes human error and enhances data security through cloud-based platforms. Remote access to financial data supports

efficient financial planning and strengthens internal control systems.

Conclusion:

Accounting practices are fundamental to the financial stability and long-term sustainability of MSMEs. Beyond meeting statutory requirements, effective accounting supports operational efficiency, informed decision-making, and strategic growth. Despite their vital contribution to the economy, many MSMEs continue to face challenges in maintaining proper accounting systems due to limited resources, lack of expertise, and regulatory complexities.

Strengthening accounting practices through awareness programs, adoption of digital tools, simplified reporting frameworks, and professional guidance can significantly improve the financial health and credibility of MSMEs. As the MSME sector continues to drive economic development, robust accounting practices will remain essential for ensuring transparency, competitiveness, and resilience.

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