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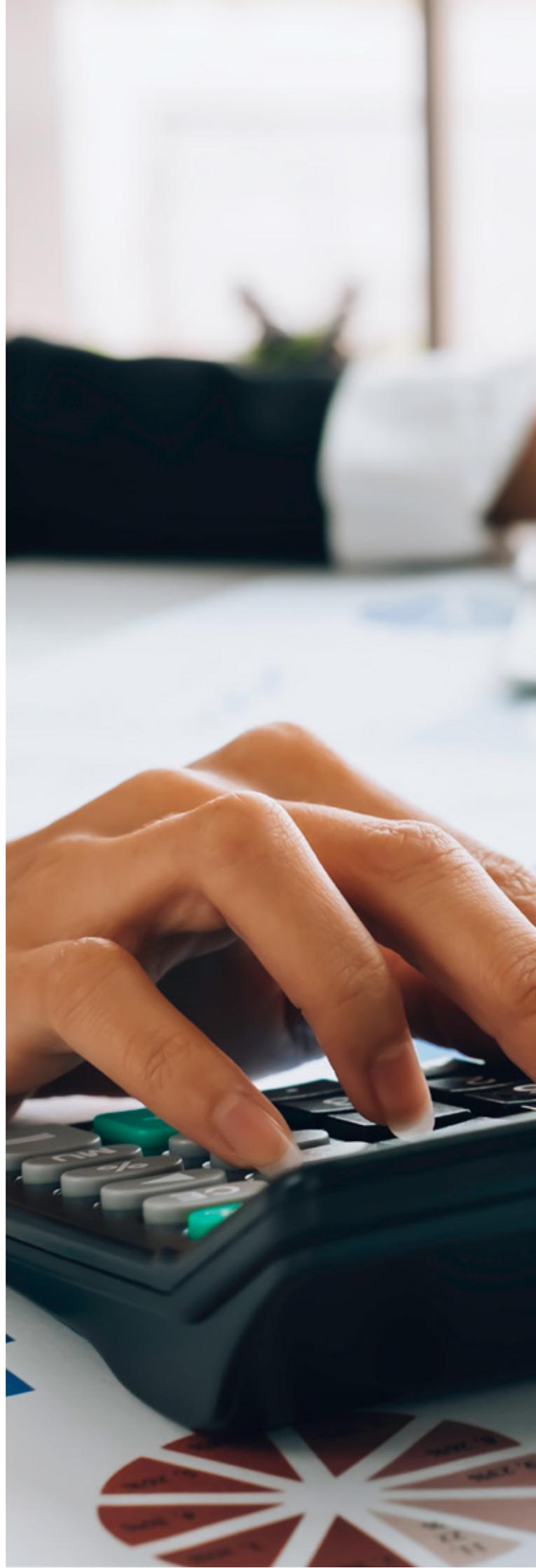
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## Measure it to Manage it: The Role of Proper Accounting in the Success of SMEs in Iraq

Studies have shown that one of the significant reasons for startups and small and medium-sized enterprises (SMEs) to fail is due to poor record-keeping; according to The Guardian - Nigeria's 2016 article "Research Hinges 70% of SMEs Failure on Poor Bookkeeping." Typically, the last thing on the mind of the entrepreneur of a startup or an SME is to maintain proper accounting records. These owners/managers are predominantly embroiled with implementing their business ideas, with little energy going into developing a proper accounting system.

They frequently have expenses and invoices sitting in a box, in a corner in the office, and sometimes they try to run it on excel, which usually does not work. Because of the disorganization, they start running into operational troubles due to cash flows. The problem is exacerbated when they need loans or additional funds from angel investors, as they can not provide the necessary reports expected from investors and lenders.





These businesses think that they can deal with accounting later when it becomes a necessity, which might be too little too late as the business might be on its projection of falling. It is like putting off going to the dentist until one is in pain, which might be too late to save the tooth.

In the USA, where I have advised many SMEs, business owners select three service providers prior to forming the business: a good lawyer, a good banker, and a good accountant.

A good lawyer to guide them through the best legal business format and help draft the formation documents; a good banker to secure adequate loans and manage cash flows; a good accountant who can help set up a proper accounting system to capture data and provide financial reports to help the owner/manager make proper daily managerial decisions.

The management Guru, Dr. Peter Drucker, famously said, "if you can not measure it, you can not manage it." The proper accounting system will measure the economic activities of the business and provide the required reports to help the owner/manager manage their business.

This is a formula for success. A lack of a good accounting system at the earliest stages may contribute to the failure of the business as the owner/manager will not have measurable data to report how well the business is doing in terms of profit or loss, how much the business owns and owes to others, and a clear idea about the business cash inflows and outflows.

So why Iraqi business owners/managers do not assign a high value to keep proper accounting records? It is worth noting that there is no research conducted to provide empirical evidence about the aptitude of Iraqi business owners/managers toward keeping and using proper accounting reports. Therefore, I will briefly discuss some of the reasons based on anecdotal evidence and my personal observations.

**First**, owners/managers think they know their business without documenting it in a formal accounting system. Rather, the information is in their head or on the back of an envelope. After all, they know how much cash the business has generated, how much is used up, and how much is left in hand. Although knowing cash flows is essential to any business as cash is king, a proper accounting system will provide additional information.

The provided information should include how well the business is doing through the statement of profit or loss, how much the business owns, owes to others, and the claims of the owners through the balance sheet, and of course, information about the sources and uses of cash flows through the statement of cash flows.

These collectively are called financial statements. Although the financial statements tell a lot about a business, further analysis by experts can tell even more of the story of the business.

A trained professional accountant can analyze these statements and will be able to provide insight into the strength and weaknesses of a business, such as gross profit, selling and administrative expenses, net profit or loss, break even, overhead, fixed cost and variable cost, level of liquidity, level of leveraging, return on investment, and so on and so forth.

Of course, such analysis will not be possible without keeping a proper set of books that are updated continuously, on a periodic basis; daily, weekly, or monthly. In addition, a trained professional accountant can design and install an appropriate internal control system, especially when there are employees, such as segregation of duties and protecting assets such as cash, equipment, and inventories.

**Second**, the negative influence of the arcane Iraqi uniform accounting system. This system was introduced in the eighties to align with Iraq's governmental accounting system and the tax

authority. However, this system is not useful for the owners/managers to manage their businesses. Despite the many attempts by the International Monetary Fund (IMF) and the World Bank to replace this system with International Financial Reporting Standards (IFRS), Iraqi government and businesses have not adopted IFRS.

Part of the issue is that Iraqi professional accountants are not trained on IFRS and, thus, shy away from it. IFRS is the way forward to reform Iraq's accounting practice and profession, empower SMEs, and attract foreign investors as they demand accounting information in accordance with IFRS. More than 160 countries and jurisdictions have adopted IFRS. If IFRS is good enough for 160 countries, it must be good enough for Iraq to adopt it urgently.

**Third**, many SMEs purposely avoid keeping proper books certified by professional accountants to avoid the axe of the tax assessor. As a result, many business owners/managers would hide their actual revenues or show a manufactured income. This certainly is not just illegal, but it would create a culture of corruption that implicates the business community and professional accountants alike. Many owners/managers will seek accountants who can help them short the tax assessor.

The tax authority is also to be blamed, as the perception of the business community is that tax rules and regulations are not well understood, arbitrary, inequitable, and unfair. In addition, there is no due process to challenge the tax assessment, or it might take years to resolve.

Also, the perception is that tax agents are aggressive, do not understand the owners' businesses and some are simply outright corrupt.

## What to do?

Many business owners/managers do not know where and how to acquire or initiate a sound accounting system. The first step is to find a professional accountant who understands and deals with startups and SMEs.

This service provider will help advise and guide the SMEs in setting up charts of accounts, and migrating data from the source document, such as excel or other accounting software.

This external accountant can act as an outsourced CFO for the business. Second, digitize the accounting system in its entirety. This can be rather inexpensive as countless off-the-shelf cloud-based accounting software can be easily installed and maintained.

The advantage of the cloud-based system over the desktop system is that the cloud-based system is more secure as data is updated and saved instantly on secured servers and can be accessed from any device anywhere in the world which provides greater flexibility in reaching the data from a desktop, a laptop or a smartphone.

Also, more than one user can access the software simultaneously with a different authorization level. Many of these software programs can handle:

- Invoicing.
- Bank and credit card reconciliations.
- Accounts payable.
- Accounts receivable.
- Financial statements preparations.
- Fixed assets.
- Inventories.
- Investments.
- Bank loans.
- Revenues and expenses.

## Summary and Conclusions

It is not a priority for startups and SMEs to maintain a proper accounting system as the owners/managers think that accounting can wait until the business is up and running and successful. Experience has shown that this can be a fatal mistake for many of these businesses as if they were driving with no headlights on a foggy road.

For these businesses to improve their chances of success, they need to engage in the strategy of management by measurement. Using accurate, timely, and relevant information will enhance the ability of the owner/manager to steer their business to profitability and get more funding from investors and banks. Iraqi startups and SMEs need to invest in a simple and adequate digital accounting system that is maintained by an in-house accountant and advised by a professional external accountant.

However, Iraq has a few trained professional accountants that can advise startups and SMEs on how to produce information that is accurate, timely, and relevant following IFRS standards.

Iraq's professional education is rooted in the uniform accounting system, which is not designed to provide information for managerial decision-making purposes. Therefore, there is plenty of room for professional accountants to help startups and SMEs.

At LEDGERS accounting and auditing, our philosophy is to empower the owner/manager in taking charge of their businesses through assurances, advisory, training, and external support. We assist in digitizing the accounting function, providing support to the company's internal accountant(s), and interpreting the financial reports to help the owner/manager manage their business effectively and efficiently.

If the company is at a medium-size, we will assist in designing and installing a digitized internal control system over the operations of the business to provide efficiency and effectiveness of the operations, produce accurate and timely financial statements and ensure compliance with laws and regulations including, but not limited to, tax and labor laws.