

**IS THE LITERACY OF SMALL BUSINESS OWNERS IMPORTANT FOR CASH FLOW MANAGEMENT?: THE EXPERTS' PERSPECTIVE**

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**ABSTRACT**

Small businesses play a crucial role in the Australian economy in terms of income and employment. Reliance on small business however can be concerning, as many small businesses fail to survive for a period of more than five years. This has been associated with the difficulty that small businesses face in maintaining a consistent cash flow. Research suggests that this may be related to financial and taxation literacy of the small business owner (SBO). Although SBOs have been identified as having a higher degree of financial literacy than individuals, it is unclear whether their level of literacy is adequate to support the management of the cash flow of their business. A continuing large research project investigates the required level of literacy that SBOs should possess to operate a successful business, with particular focus on cash flow management. This article reports expert perspectives of the degree of knowledge that is essential for SBOs in terms of professional financial literacy, computer accounting software (CAS) literacy and business taxation literacy in order to implement effective cash flow management practices.

**Keywords:** Small business; Cash flow; Tax literacy; Financial literacy; CAS literacy.

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## I INTRODUCTION

The lifecycle of many small businesses in Australia and throughout the world is less than five years.<sup>1</sup> This has been attributed in part to their struggle to maintain consistent cash levels. Cash flow management appears to be difficult for many SBOs; however, it is unclear why SBOs find it so problematic. It appears that financial literacy of SBOs may have some impact on their ability to make sound financial decisions.<sup>2</sup>

Another concern for effective management of cash flow by SBOs relates to the obligation to collect and settle tax liabilities. It has been suggested that taxation may negatively impact the ability of SBOs to maintain consistent cash levels. The current research project seeks to gain a greater understanding as to whether cash flow difficulties are a direct result of taxation or whether there are other underlying issues that influence cash flow (and/or the taxation relationship).

Considering that research has identified that the relationship between small business cash flow and tax may be distorted by other business factors including individual characteristics of the SBO, it was deemed important to investigate areas of SBO characteristics not previously studied when analysing cash flow. In particular it was determined that some specific types of SBO literacy may have an effect on the tax and cash flow relationship.<sup>3</sup> When identifying the appropriate areas of literacy, it was necessary to determine what influences a SBO's ability to understand cash flow and implement effective cash flow management strategies. These strategies can be linked to literacy of business tax systems as a number of business taxes require SBOs to understand the effects of incurring taxes today and planning for payment of the tax liability in the future.

Recent research suggests that to a large extent SBOs identify that increased literacy could be beneficial to their cash flow management.<sup>4</sup> However, when investigating the level of literacy held it was found that only 12 per cent of SBOs implemented systematic cash flow management practices in their business, and only those educated in accounting made use of financial statements to help them to determine the liquidity of their business. Also, even though SBOs recognised managerial benefits from use of computer accounting software (CAS) in the form of accurate record keeping it was apparent that CAS was not being used to support cash flow management. More than half (56 per cent) of SBOs had limited knowledge on what financial reports could be produced in their CAS, and 12.5 per cent of SBOs were not aware that they could prepare any financial reports in their CAS. This suggests that SBOs were not realising any managerial benefits in the form of cash flow

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<sup>1</sup> Australian Bureau of Statistics, *8165.0 – Counts of Australian Businesses, Including Entries and Exits, Jun 2012 to Jun 2016* (20 February 2017) <<http://www.abs.gov.au/ausstats/abs@.nsf/mf/8165.0>>; Olawale Fatoki, 'The Financial Literacy of Micro Entrepreneurs in South Africa' (2014) 40(2) *Journal of Social Sciences* 151. The survival rate of small business increases as annual turnover increases. Those generating less than AU\$200 000 per annum have a lower chance of survival than those earning over AU\$200 000.

<sup>2</sup> Fatoki, above n 1, 153.

<sup>3</sup> Melissa Belle Isle and Brett Freudenberg, 'Calm Waters: GST and Cash Flow Stability for Small Businesses in Australia' (2015) 13(2) *eJournal of Tax Research* 492.

<sup>4</sup> Toni Chardon, Brett Freudenberg and Mark Brimble, 'Tax Literacy in Australia: Not Knowing Your Deduction from Your Offset' (2016) 31(2) *Australian Tax Forum* 321; Brett Freudenberg, Toni Chardon, Mark Brimble and Melissa Belle Isle, 'Tax Literacy of Australian Small Businesses' (2017) 18(2) *Journal of Australian Tax* 21.

management from use of CAS. It appears that literacy levels of SBOs in the research may not be at a level that supports cash flow of their business. Furthermore, from the findings it appears that 25 per cent of SBOs saw little benefit in being tax literate and instead saw taxation literacy to be the role of their accountant or advisor.

As a result of these findings the current research was designed to determine whether there is a required level of literacy that SBOs should possess in order to adequately support the cash flow management requirements of their business. Small business experts from varying professions in the small business landscape were engaged to explore their views on the level of literacy required by SBOs for effective cash flow management. In particular the areas of literacy that were examined when taking cash flow management and taxation into account for small business included two parts (of four) of professional financial literacy,<sup>5</sup> CAS literacy and business taxation literacy.

This article presents the outcome of the data collected from 23 small business experts using the first stage of a Delphi technique.<sup>6</sup> The structure of this article is as follows. First, relevant literature relating to cash flow concerns of Australian small businesses is discussed. Second, an overview of prior knowledge relating to SBO literacy in terms of professional financial literacy, CAS literacy and business taxation literacy is presented. Third, the methodology employed for the research is outlined followed by the findings of the research. The article is finalised with a concluding summary and recommendations for future research.

## II SMALL BUSINESS CASH FLOW CONCERNS

A critical issue for all businesses is maintaining a consistent cash flow, which can be especially acute for small businesses due to restricted access to finance.<sup>7</sup> Cash flow is the extent of cash or near cash assets available for use, along with any inflow or outflow of cash related to these assets.<sup>8</sup> Therefore, cash flow is any business activity that alters the balance of the cash accounts. Previous research in Australia suggests that SBOs have recognised that cash flow is of particular importance to their ongoing survival,<sup>9</sup> although it can be difficult for them to manage.<sup>10</sup>

Cash flow management has been identified as one of the most important problems for businesses in the United Kingdom, the United States of America and Australia.<sup>11</sup> Effective

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<sup>5</sup> See Andrew Worthington, 'The Distribution of Financial Literacy in Australia' (School of Economics and Finance Discussion Papers and Working Papers Series 185, School of Economics and Finance, Queensland University of Technology, 2004) 6.

<sup>6</sup> The Delphi technique is discussed further in the Methodology section of this article.

<sup>7</sup> Belle Isle and Freudenberg, above n 3, 519.

<sup>8</sup> Shawn Carraher and Howard van Auken, 'The Use of Financial Statements for Decision Making by Small Firms' (2013) 26(3) *Journal of Small Business & Entrepreneurship* 323; Ignatius Ekanem, 'Liquidity Management in Small Firms: A Learning Perspective' (2010) 17(1) *Journal of Small Business and Enterprise Development* 123.

<sup>9</sup> Melissa Belle Isle, Brett Freudenberg and Richard Copp, 'Cash Flow Benefit from GST: Is It Realised by Small Businesses in Australia?' (2014) 29(3) *Australian Tax Forum* 417; Ian Wallschutzky and Brian Gibson, 'Small Business Cost of Tax Compliance' (1993) 10(4) *Australian Tax Forum* 511, 527.

<sup>10</sup> Belle Isle and Freudenberg, above n 3; Fatoki, above n 1.

<sup>11</sup> Scott Holmes and Des Nicholls, 'An Analysis of the Use of Accounting Information by Australian Small Business' (1998) 26(2) *Journal of Small Business Management* 57, 57; Michael Peel, Nicholas Wilson and

cash management is important to business survival irrespective of the size of the business.<sup>12</sup> When assessing small business liquidity it has been suggested that small businesses are less liquid and exhibit more volatility with cash flow and profit than their larger competitors.<sup>13</sup> It has been observed that SBOs should try to avoid extended cash shortages, as supply constraints can affect the ongoing operations of the business and thereby make situations worse.<sup>14</sup> In order to reduce cash constraints and achieve better control of cash flow, SBOs need to implement effective liquidity management practices.<sup>15</sup>

Effective liquidity management consists of keeping financial accounts, maintaining a business plan and cash budget, keeping records of revenue and expenses, creditor and debtor invoicing and maintaining an inventory schedule.<sup>16</sup> Previous research in Australia and the UK suggests that SBOs are not actively involved in systematic liquidity management practices.<sup>17</sup> While day-to-day recording of activities involving cash inflow and outflow may be undertaken, the process involved in receiving and making payment for those activities or managing cash once received may not be actively conducted.<sup>18</sup>

The strengths of an SBO at commencement of their business revolve around the technical skill set of that owner.<sup>19</sup> Research suggests that SBOs are lacking financial management skills at start-up of their business (with the exception of businesses related to finance or accounting).<sup>20</sup> Research proposes that liquidity management should be regarded as important at the start and throughout the growth of the business.<sup>21</sup> Advances or procurement of new liquidity management skills are adopted with time and business development.<sup>22</sup> This often occurs as a result of external events or stakeholders that force SBOs to learn new procedures and routines.<sup>23</sup> For instance, if a SBO has never been required to prepare a cash budget or business plan for an external party, they may never be aware of the role that these documents can play in assisting with effective cash flow management practices.<sup>24</sup>

The level of proficiency of the SBO in relation to cash flow management is not solely reflective of the owner's abilities and capacity.<sup>25</sup> Cash flow management practices can be

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Carole Howorth, 'Late Payment and Credit Management in the Small Firm Sector: Some Empirical Evidence' (2000) 18(2) *International Small Business Journal* 17, 19.

<sup>12</sup> Arthur R DeThomas and William B Fredenberger, 'Accounting Needs of Very Small Business' (1985) 55(10) *The CPA Journal* 14; Fatoki, above n 1.

<sup>13</sup> Peel, Wilson and Howorth, above n 11, 19.

<sup>14</sup> Fatoki, above n 1; Ekanem, above n 8, 124–5.

<sup>15</sup> Peel, Wilson and Howorth, above n 11, 19–24.

<sup>16</sup> Alejandro Drexler, Greg Fischer and Antoinette Schoar, 'Keeping It Simple: Financial Literacy and Rules of Thumb' (2014) 6(2) *American Economic Journal: Applied Economics* 1, 13; Ekanem, above n 8, 125.

<sup>17</sup> Belle Isle and Freudenberg, above n 3, 514; Freudenberg et al, above n 4, 34; Peel, Wilson and Howorth, above n 11, 19.

<sup>18</sup> Belle Isle and Freudenberg, above n 3, 514; Peel, Wilson and Howorth, above n 11, 19.

<sup>19</sup> DeThomas and Fredenberger, above n 12; Freudenberg et al, above n 4, 29.

<sup>20</sup> Freudenberg et al, above n 4, 30; Peel, Wilson and Howorth, above n 11, 19.

<sup>21</sup> Peel, Wilson and Howorth, above n 11, 19.

<sup>22</sup> David Deakins, Alana Morrison and Laura Galloway, 'Evolution, Financial Management and Learning in the Small Firm' (2002) 9(1) *Journal of Small Business and Enterprise Development* 7, 9.

<sup>23</sup> *Ibid* 15, 16.

<sup>24</sup> *Ibid*.

<sup>25</sup> Abdel K Halabi, Rowena Barrett and Robyn Dyt, 'Understanding Financial Information Used to Assess Small Firm Performance' (2010) 7(2) *Qualitative Research in Accounting & Management* 163, 169.

influenced by the SBO's attitude or the value they place on having effective procedures within their business.<sup>26</sup> Results from previous research advocates that a large number of SBOs undervalue the importance of cash flow management practices in their business decision-making, with more value placed on information gathered from market research.<sup>27</sup> Management of cash and credit was rated second last of all management functions, and only a minority of business owners identified any benefit from acquiring any form of cash management training.<sup>28</sup> SBOs appear to adopt a minimum standard rather than attempting to achieve a level of best practice when it comes to cash flow management.<sup>29</sup> This may be a result of SBOs having low levels of literacy and understanding about the benefits of having an effective cash flow management system in place and how it can be achieved.<sup>30</sup>

### III SMALL BUSINESS OWNER LITERACY

Of interest to the current study of cash flow are the concepts of SBO literacy in terms of professional financial literacy, CAS literacy and business taxation literacy. These areas of literacy are explored further throughout this section and the remaining sections of the article.

#### *A Professional financial literacy*

Financial literacy can be described as having the competence to successfully make efficacious decisions and cognitive judgements in financial circumstances that have the ability to influence an individual's financial status or position.<sup>31</sup> Another term often used in place of financial literacy is 'financial capability'. Financial capability however, takes into consideration an individual's personal financial skills, attitudes and characteristics when attempting to determine their financial decision-making.<sup>32</sup> For the purpose of this article financial literacy and financial capability will be viewed as one in the same.

Having financial literacy skills is an essential basis for both avoiding and solving financial problems.<sup>33</sup> Business owners have been identified as having greater financial literacy than other groups of individuals.<sup>34</sup> This includes SBOs, who have a higher level of financial

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<sup>26</sup> Ibid.

<sup>27</sup> Holmes and Nicholls, above n 11, 59; Peel, Wilson and Howorth, above n 11, 24.

<sup>28</sup> Peel, Wilson and Howorth, above n 11, 31-2.

<sup>29</sup> Deakins, Morrison and Galloway, above n 22, 9; Ekanem, above n 8, 135.

<sup>30</sup> Deakins, Morrison and Galloway, above n 22, 11.

<sup>31</sup> Sandra J Huston, 'Measuring Financial Literacy' (2010) 44(2) *Journal of Consumer Affairs* 296, 303; Freudenberg et al, above n 4, 23; Annamaria Lusardi and Olivia S Mitchell, 'The Economic Importance of Financial Literacy: Theory and Evidence' (2013) 52(1) *SSRN Electronic Journal* 5; Worthington, above n 5, 6.

<sup>32</sup> Toni Brackin, *Taxation as a Component of Financial Literacy: How Literate Are Australians in Relation to Taxation* (PhD Thesis, Griffith University, 2014) 22; Freudenberg et al, above n 4, 23.

<sup>33</sup> Freudenberg et al, above n 4, 23; Sonia Marcolin and Anne Abraham, 'Financial Literacy Research: Current Literature and Future Opportunities' in P Basu, G O'Neill and A Travaglione (eds), *Proceedings of the 3rd International Conference on Contemporary Business* (Leura, NSW, Australia, 21-22 September 2006) 3.

<sup>34</sup> Reva Berman Brown, Mark N K Saunders and Richard Beresford, 'You Owe It to Yourself: The Financially Literate Manager' (2006) 30(2) *Accounting Forum* 171, 188; Freudenberg et al, above n 4, 25. Other

awareness than other individuals.<sup>35</sup> However, the financial literacy required to operate a small business is greater than that required for individual success.<sup>36</sup> Previous research suggests that SBOs lack the required level of financial literacy to make important financial decisions for their business.<sup>37</sup>

The level of financial literacy required can depend upon someone's role. For example, the financial literacy expected of directors has been identified as professional financial literacy and includes having an understanding of financial statements, cash flow management, internal control mechanisms and corporate governance.<sup>38</sup> Financial statements that are of particular importance to professional financial literacy include the balance sheet, income statement, cash flow statements and the preparation of a cash budget.<sup>39</sup> This is due to their relevance to cash flow management and the influence that these statements can have on determination of business solvency by the SBO.<sup>40</sup>

Solvency of small business is a critical part of small business management and is dependent on the level of professional financial literacy that the business owner possesses.<sup>41</sup> Solvency is achieved through careful cash planning and control, which requires the owner to understand the financial position and activities of the organisation.<sup>42</sup> SBO professional financial literacy can influence firm growth and productivity, and those with higher levels of financial literacy have been known to be more effective when using financial products and are more engaged in using and offering trade credit.<sup>43</sup> It has also been found that those with high levels of literacy are more likely to improve their literacy through using professional advisors whereas those with lower levels of literacy are more likely to rely on financial advice from friends and family, which could have negative effects on their improving their professional financial literacy in the long term.<sup>44</sup>

Adequate financial literacy for SBOs can assist with everyday functions in the business. This can enable the SBO to evaluate financial information in order to make decisions while understanding the consequences of those decisions.<sup>45</sup> Preparation and use of financial statements can assist business owners to make more informed decisions and can facilitate improved performance. Information from financial statements can illustrate the

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individuals with high levels of financial literacy include those with a tertiary education, professional occupation or a member of a couple with no children.

<sup>35</sup> Berman Brown, Saunders and Beresford, above n 34, 188.

<sup>36</sup> Freudenberg et al, above n 4, 25.

<sup>37</sup> Drexler, Fischer and Schoar, above n 16, 1–2; Fatoki, above n 1; Freudenberg et al, above n 4, 25.

<sup>38</sup> Worthington, above n 5, 5.

<sup>39</sup> Berman Brown, Saunders and Beresford, above n 34, 188.

<sup>40</sup> Fatoki, above n 1, 153.

<sup>41</sup> Berman Brown, Saunders and Beresford, above n 34, 179–80.

<sup>42</sup> DeThomas and Fredenberger, above n 12, 21; Fatoki, above n 1.

<sup>43</sup> Miriam Bruhn and Bilal Zia, 'Stimulating Managerial Capital in Emerging Markets: The Impact of Business Training for Young Entrepreneurs' (2013) 5(2) *Journal of Development Effectiveness* 232, 234 and 238; Fatoki, above n 1, 152.

<sup>44</sup> Tabea Bucher-Koenen, Annamaria Lusardi, Rob Alessie and Maarten van Rooji, 'How Financial Literate Are Women? An Overview and New Insights' (NBER Working Paper No 20793, National Bureau of Economic Research, December 2014) 13.

<sup>45</sup> Berman Brown, Saunders and Beresford, above n 34, 179–80; Fatoki, above n 1, 152.



consequences of the business operations.<sup>46</sup> Financial statements can also be used to measure profitability, perform ratio analysis, and assist with providing information to external stakeholders including financial institutions and banks.<sup>47</sup> An important advantage of small businesses using financial statements is that it can provide them with up-to-date cash flow information. Cash flow records can have greater usefulness to small businesses than accrual information when determining solvency, as preparation of reports relevant to cash flow provides a more accurate assessment of the present status of the business, and may assist with implementing strategies to overcome any cash flow problems.<sup>48</sup>

Regardless of the abundance of research that suggests that use of financial statements is valuable to the ongoing success of small businesses, it appears that small businesses in Australia and overseas make limited use of financial statements to assist them in managing their business.<sup>49</sup> Although a large proportion of SBOs believe that evaluation and use of financial statements is their responsibility, previous research in Australia suggests that only 30 per cent use reports for decision-making, 20 per cent perform any form of ratio analysis, 11 per cent use the information to evaluate business performance and 10 per cent use current financial information for future plans or budgets.<sup>50</sup> Research both in Australia and overseas suggests that limited use of financial statements could be explained by education levels of the SBO.<sup>51</sup> More educated SBOs are deemed better equipped at analysing and interpreting the figures presented in the statements.<sup>52</sup>

In addition to literacy, SBOs indicate that the limited use of financial reports was a result of minimal significance placed on the information available in the statement, especially with regard to income statements and balance sheets.<sup>53</sup> SBOs believed that the main purpose of record keeping and producing reports was for tax compliance requirements, rather than being a worthwhile source of information and insight for management decisions.<sup>54</sup> That is, there is a lack of perception of any managerial benefit received from accounting records, other than for tax records/returns.<sup>55</sup> This confusion about the benefits of record keeping can be demonstrated in compliance cost research, where

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<sup>46</sup> Bruhn and Zia, above n 43, 234 and 248.

<sup>47</sup> Robyn Dyt and Abdel K Halabi, 'Empirical Evidence Examining the Accounting Information Systems and Accounting Reports of Small and Micro Business in Australia' (2007) 15(2) *Small Enterprise Research* 1, 5; Fatoki, above n 1, 153; Halabi, Barrett and Dyt, above n 25, 167.

<sup>48</sup> Divesh S Sharma and Errol R Iselin, 'The Decision Usefulness of Reported Cash Flow and Accrual Information in a Behavioural Field Experiment' (2003) 33(2) *Accounting and Business Research* 123.

<sup>49</sup> Carraher and van Auken, above n 8; DeThomas and Fredenberger, above n 12; Dyt and Halabi, above n 47; Halabi, Barrett and Dyt, above n 25, 163; Peel, Wilson and Howorth, above n 11; Sharma and Iselin, above n 48.

<sup>50</sup> Dyt and Halabi, above n 47, 5; Halabi, Barrett and Dyt, above n 25, 167. A limitation of the Australian research is that the number of participants was 10.

<sup>51</sup> Carraher and van Auken, above n 8, 333; DeThomas and Fredenberger, above n 12, 20; Halabi, Barrett and Dyt, above n 25, 171-4.

<sup>52</sup> Carraher and van Auken, above n 8, 333; DeThomas and Fredenberger, above n 12, 20; Halabi, Barrett and Dyt, above n 25, 171-4.

<sup>53</sup> Halabi, Barrett and Dyt, above n 25, 171.

<sup>54</sup> *Ibid* 168.

<sup>55</sup> Nahida Faridy, Brett Freudenberg, Tapan Sarker and Richard Copp, 'The Hidden Compliance Cost of VAT: An Exploration of Psychological and Corruption Costs of VAT in a Developing Country' (2016) 14(1) *eJournal of Tax Research* 166.

compliance costs have been miscategorised as a tax cost when it is more a cost about basic record keeping for a business.<sup>56</sup> More importance can be placed on remaining up-to-date with the cash at bank balance, with this figure perceived to be a more accurate measure of performance.<sup>57</sup> Accordingly, while SBOs can identify that cash is essential for survival of their business, research suggests that they still do not see the importance of using financial reports, like a cash flow budget or cash flow statement, to assist them in managing their cash flow.<sup>58</sup> It appears that this may be a result of their inability to comprehend the information contained in the financial reports in order to improve the performance of their business.<sup>59</sup>

### **B Computer accounting software literacy**

CAS has been advocated as being of great importance to small business success. Since the introduction of the GST in 2000 and increases in the personal use of information technology, it is posited that a large number of small businesses in Australia use a CAS system for record keeping in their business.<sup>60</sup>

For a CAS system to be effective to a small business it should be simple to maintain by the owner,<sup>61</sup> as the SBO is likely to be active in record keeping rather than having a delegated employee. Potentially this allows the SBO to gain a greater understanding of the financial strengths and weaknesses of the business.<sup>62</sup> A CAS system allows SBOs to collect and collate information from transactions for use in a timely manner, without having to request this information from accountants.<sup>63</sup>

Australian research suggests that SBOs do not use their CAS to its full potential.<sup>64</sup> Indeed, the majority of SBOs do not produce financial reports from their CAS.<sup>65</sup> The reasoning for non-generation of reports was that SBOs do not understand accounting language, conventions or terms (that is, have low professional financial literacy), and therefore see limited value in generating a report that they do not understand.<sup>66</sup> Also, it appeared that

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<sup>56</sup> Chris Evans, K Ritchie, Binh Tran-Nam and Michael Walpole, 'Taxation Compliance Costs: Some Recent Empirical Work and International Comparisons' (1997) 14 *Australian Tax Forum* 93; Philip Lignier and Chris Evans, 'The Rise and Rise of Tax Compliance Costs for the Small Business Sector in Australia' (2012) 27(3) *Australian Tax Forum* 615.

<sup>57</sup> Halabi, Barrett and Dyt, above n 25, 167-74.

<sup>58</sup> DeThomas and Fredenberger, above n 12, 18-19; Fatoki, above n 1.

<sup>59</sup> Gerard Stone, 'Let's Talk: Adapting Accountants' Communications to Small Business Managers' Objectives and Preferences' (2011) 24(6) *Accounting, Auditing & Accountability Journal* 781, 785.

<sup>60</sup> Philip Lignier, *Identification and Evaluation of the Managerial Benefits Derived by Small Businesses as a Result of Complying with the Australian Tax System* (PhD Thesis, University of New South Wales, 2008) 25; Lignier and Evans, above n 56.

<sup>61</sup> DeThomas and Fredenberger, above n 12, 21; Stone, above n 59.

<sup>62</sup> Fatoki, above n 1, 156.

<sup>63</sup> Carraher and van Auken, above n 8; Halabi, Barrett and Dyt, above n 25, 166.

<sup>64</sup> Belle Isle and Freudenberg, above n 3; Melissa Belle Isle, Brett Freudenberg and Tapan Sarker, 'The Small Business Cash Flow Struggle: What Role Does Owner Literacy Play?' (Working Paper, Griffith University, 2017); Halabi, Barrett and Dyt, above n 25, 166.

<sup>65</sup> Ibid.

<sup>66</sup> DeThomas and Fredenberger, above n 12, 22-3; Halabi, Barrett and Dyt, above n 25, 168.



10 per cent of SBOs were unaware that they could even produce financial reports from their CAS.<sup>67</sup>

Recent Australian research indicates that the CAS is not being used effectively to assist with management of cash flow, with low engagement in the use of CAS reporting options.<sup>68</sup> As a result, participants were spending considerable time arranging finances for payment of liabilities.<sup>69</sup> In contrast recent international research suggests that individuals who make regular use of tax software are more financially aware.<sup>70</sup> The difference could be explained by the existence of a position indicator in the tax software used in the United States of America.<sup>71</sup> It could be argued that CAS systems available to SBOs in Australia are also capable of providing an indicator of cash flow position, however this would be reliant on timely recording of transactions.

As a result, it is argued that the low utilisation of CAS is in part the result of limited knowledge (literacy) about the functions of the CAS system and the benefits that can be realised from using the CAS for cash flow management in a small business.

### ***C Business taxation literacy***

Recent research by Chardon, Freudenberg and Brimble<sup>72</sup> and Freudenberg, Chardon, Brimble and Belle Isle<sup>73</sup> suggest that understanding of tax systems is beneficial to a person's overall financial position. The level of knowledge that an individual possesses of tax systems is posited to have a relationship with their ability to communicate with advisors, budget, make decisions and understand their rights and obligations.<sup>74</sup> It was proposed that there is a base level of taxation and superannuation literacy or knowledge required in order to be financially literate.<sup>75</sup>

Recent research conducted in Australia found that individuals that are involved in business are more literate in regard to individual taxation requirements than those who are not.<sup>76</sup> However, the level of tax literacy in relation to business tax systems does not appear to be adequate for management of their business tax requirements.<sup>77</sup>

Research in the 1990's suggested that SBOs needed to spend more time improving their level of tax knowledge. McKerchar<sup>78</sup> proposed that SBOs experience difficulty with

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<sup>67</sup> Halabi, Barrett and Dyt, above n 25, 171.

<sup>68</sup> Belle Isle and Freudenberg, above n 3; Belle Isle, Freudenberg and Sarker, above n 64.

<sup>69</sup> Belle Isle, Freudenberg and Copp, above n 9.

<sup>70</sup> Nicholas C Hunt and Govind S Iyer, 'The Effect of Tax Position and Personal Norms: An Analysis of Taxpayer Compliance Decisions Using Paper and Software' (2018) 41 *Advances in Accounting* 1.

<sup>71</sup> Hunt and Iyer, above n 70.

<sup>72</sup> Chardon, Freudenberg and Brimble, above n 4.

<sup>73</sup> Freudenberg et al, above n 4.

<sup>74</sup> Chardon, Freudenberg and Brimble, above n 4; Freudenberg et al, above n 4, 26.

<sup>75</sup> Toni Chardon, 'Weathering the Storm: Tax as a Component of Financial Capability' (2011) 5(2) *Australasian Accounting Business & Finance Journal* 53 <<http://ro.uow.edu.au/cgi/viewcontent.cgi?article=1168&context=aabfj>>; Freudenberg et al, above n 4, 26.

<sup>76</sup> Chardon, Freudenberg and Brimble, above n 4; Freudenberg et al, above n 4, 45.

<sup>77</sup> Freudenberg et al, above n 4, 26; Margaret McKerchar, 'Understanding Small Business Taxpayers: Their Sources of Information and Level of Knowledge of Taxation' (1995) 12 *Australian Tax Forum* 25, 40.

<sup>78</sup> McKerchar, above n 77, 32-5.

understanding superannuation guarantee (SG), income tax, provisional tax<sup>79</sup> and fringe benefit tax. McKerchar found that SBOs experienced difficulty in determining which benefits were classified as a fringe benefit, which employees attracted SG and what deductions were allowable.<sup>80</sup> More recent research findings indicate that SBO tax literacy may have improved in regard to allowable deductions, as 69 per cent of GST business operators<sup>81</sup> could differentiate between assets that were immediately deductible in comparison to those that would depreciate over time.<sup>82</sup> This may be a similar outcome for determination of correct dates for lodgement and payment of the tax liability. SBOs experienced complexity in identifying the reporting and payment requirements of tax systems in the 1990s. In comparison, 71 per cent of SBOs were confident that they accurately meet their GST recording and reporting obligations in research conducted in 2017.<sup>83</sup>

Also, a significant number of SBOs in the research by McKerchar<sup>84</sup> had a limited understanding of provisional tax, the forerunner to the PAYG (pay as you go) instalment. SBOs had difficulty comprehending that a payment of provisional tax decreased the overall amount of tax liability due at the end of the financial year.<sup>85</sup> The level of SBO literacy in terms of the current PAYG instalment system is unclear.

While research found that more than 90 per cent of SBOs suggested that they pursued tax information from various sources including advisors and the Australian Taxation Office (ATO), these practices were rarely undertaken by SBOs.<sup>86</sup> Also, evidence suggested that SBOs are not proactive in improving their tax knowledge, which was substantiated during prior studies when researchers provided respondents with information of taxes that were identified as being complex. The participants did not make use of the information during the time that the research was conducted.<sup>87</sup> It was suggested that there were two primary reasons for the lack of uptake of the tax information.

First, tax obligations were a low priority for SBOs, with greater importance placed on income earning activities.<sup>88</sup> A second possible reason was that SBOs perceived that they were knowledgeable about business tax matters,<sup>89</sup> and once business owners believed that they were well informed about a specific tax matter they did not review or revise their tax management practices at a later date. As a result, SBOs were oblivious to any changes to legislation or misrepresentations of tax law that occurred at a later time.<sup>90</sup> This is supported by findings of 'GST business operators' in a study conducted more recently

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<sup>79</sup> Provisional tax was replaced and the new system is known as PAYG instalments, covered under *A New Tax System (Pay As You Go) Act 1999* (Cth).

<sup>80</sup> Freudenberg et al, above n 4, 27; McKerchar, above n 77, 34.

<sup>81</sup> In Freudenberg et al, above n 4, SBOs were identified as 'GST Business Operators'.

<sup>82</sup> Freudenberg et al, above n 4.

<sup>83</sup> Ibid 48.

<sup>84</sup> McKerchar, above n 77, 34.

<sup>85</sup> Provisional tax was essentially pre-payments of an estimated income tax liability. So once a tax return was lodged for the year, the overall tax liability owing would be reduced by the prior instalment (provisional tax) paid.

<sup>86</sup> McKerchar, above n 77, 30.

<sup>87</sup> Ibid 32; Wallschutzky and Gibson, above n 9, 528.

<sup>88</sup> McKerchar, above n 77, 36; Wallschutzky and Gibson, above n 9, 528.

<sup>89</sup> McKerchar, above n 77.

<sup>90</sup> Ibid 35.

on Australian business tax payers.<sup>91</sup> It was purported that SBOs may struggle to stay up-to-date with continual changes in tax laws and the resultant outcome could be that they fail to maintain the required level of literacy to efficiently comply with the tax systems relevant to their business.<sup>92</sup>

Further reasoning for limited tax literacy was determined to relate to expert advisors. SBOs placed great reliance on their accountant to carry out and understand all tax matters relevant to their business.<sup>93</sup> This is supported by more recent findings by Freudenberg et al, who suggested that those SBOs who had been in business for a substantial period of time had lower levels of tax literacy, as they relied heavily on advisors to carry out their business tax obligations.<sup>94</sup> McKerchar indicated that there was a need to improve tax literacy of SBOs, but noted that if SBOs did not perceive that being tax literate was important or if they did not recognise that there was a shortfall in the level of tax literacy they possessed, then any attempt at educating them would be futile.<sup>95</sup> Therefore, it appears that the personal perceptions of SBOs may be a critical motivator in whether they want to improve their tax literacy. Recent research into literacy of trustees of a self-managed super fund suggests that literacy has a positive association with fund compliance.<sup>96</sup> This could suggest that it would be advantageous for SBOs to remain at a level of taxation literacy to ensure that they are compliant with relevant tax systems.

Consequently, it can be appreciated that SBOs need literacy in a number of areas including professional financial, CAS and business taxation literacy. Although prior research suggests that SBOs may have higher literacy when compared to the broader public, it is questionable whether their literacy level is sufficient to operate a business and whether it influences their cash flow management practices.

#### IV METHODOLOGY

This article reports the findings of data collected from small business experts to greater understand the level of literacy required in terms of professional financial, CAS and business taxation<sup>97</sup> literacy in order for SBOs to successfully manage their business cash flow. The research question being addressed in this article is: *Are cash flow management practices in small businesses influenced by literacy of small business owners?*

It is important to acknowledge that this study forms part of a larger research project involving Australian small businesses. The views and opinions of SBOs are the primary focus in the larger project. The justification for including experts in the larger project was to validate and compare responses of SBOs due to the heterogeneity of the small business

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<sup>91</sup> Freudenberg et al, above n 4.

<sup>92</sup> Ibid 50.

<sup>93</sup> McKerchar, above n 77, 36.

<sup>94</sup> Freudenberg et al, above n 4, 39.

<sup>95</sup> McKerchar, above n 77, 40.

<sup>96</sup> George Mihaylov, John Tretola, Alfred Yawson and Ralf Zurbruegg, 'Tax Compliance Behaviour in Australian Self-Managed Superannuation Funds' (2015) 13(3) *eJournal of Tax Research* 740.

<sup>97</sup> The PhD project for which the data related to this article was collected focuses on five tax obligations with which small businesses might comply, including: goods and services tax, fringe benefit tax, income tax, PAYG withholding and superannuation guarantee (not a tax system). It should be acknowledged that experts were not asked to talk specifically about these systems in the semi-structured interviews.

sector. Diversity of small businesses is particularly evident in terms of taxability, ownership, flexibility, industry, economies of scale, financial market access and level of information asymmetry. This diversity can make it difficult to ascertain any commonality between one small business and the next.

### ***A The Delphi technique***

The strategy of inquiry implemented for this part of the project and relevant to this article involved the first (of two) stages of a Delphi technique.<sup>98</sup> The Delphi technique is a systematic, repetitive process of collecting opinions or views from a group of experts.<sup>99</sup> Its objective is to clarify, explain or obtain consensus from experts in relation to an event or phenomenon.<sup>100</sup> The use of expert opinions as opposed to other individuals is justified on the basis that their opinions will be logical or sensible in comparison to having irrational judgement.<sup>101</sup> Knowledge of experts in relation to a particular issue is independently collected and results are combined to give an overview of all expert responses.<sup>102</sup> The collective results are used to vary or ratify the original data collection instrument, which is then redistributed to the same group of experts at a time in the future.<sup>103</sup> The purpose of altering the original instrument as a result of collective expert opinions is to reveal whether individual judgements are revised as a result of reviewing the collective expert feedback or whether experts are steadfast in their original responses.<sup>104</sup>

The Delphi technique for this article was conducted in the qualitative phase immediately after the conclusion of a multiple case study of Australian small service-related businesses. Data collection instruments were created in the form of a semi-structured interview and a series of short survey questions from the collective findings from the multiple case study and prior literature in an attempt to substantiate the responses of SBOs. The design of the Delphi technique for the research was adapted to suit the validation role of experts in the project. That is, the responses of SBOs in the multiple case study shaped the interview questions and short survey questions posed to experts.<sup>105</sup>

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<sup>98</sup> It is anticipated that future publications for this research, once both Delphi stages are completed, will discuss the application of the Delphi to the research in more depth, including strengths and weaknesses that were recognised.

<sup>99</sup> Chris Evans, 'Unravelling the Mysteries of the Oracle: Using the Delphi Methodology to Inform the Personal Tax Reform Debate in Australia' (2007) 5(1) *eJournal of Tax Research* 105, 107; Jon Landeta, 'Current Validity of the Delphi Method in Social Sciences' (2006) 73(5) *Technological Forecasting and Social Change* 467, 468-9.

<sup>100</sup> Monica R Geist, 'Using the Delphi Method to Engage Stakeholders: A Comparison of Two Studies' (2010) 33(2) *Evaluation and Program Planning* 147, 148 and 152; Chitu Okoli and Suzanne D Pawlowski, 'The Delphi Method as a Research Tool: An Example, Design Considerations and Applications' (2004) 42(1) *Information & Management* 15.

<sup>101</sup> Geist, above n 100, 148 and 152; Landeta, above n 99, 468-9.

<sup>102</sup> Geist, above n 100, 148 and 152; Landeta, above n 99, 468-9.

<sup>103</sup> Okoli and Pawlowski, above n 100.

<sup>104</sup> Theodore Gordon and Adam Pease, 'RT Delphi: An Efficient, "Round-Less" Almost Real Time Delphi Method' (2006) 73(4) *Technological Forecasting and Social Change* 321, 322.

<sup>105</sup> The findings from experts will then be used in conjunction with the multiple case study to create a large-scale survey that will be completed by Australian small service-related businesses. The findings of the large-scale survey will then be used to create a second survey that will form the second part of the Delphi technique and will be completed only by those experts that participated in the first part of the Delphi.

The purpose of the short survey was to address findings from the multiple case study that required validation and incorporate areas of literature that required further examination of literacy relevant to SBOs and cash flow management.<sup>106</sup> The short survey questions were administered verbally by the researcher, and participants were required to give a quick response on a Likert-type scale between ‘Strongly Disagree’ and ‘Strongly Agree’. The semi-structured interview questions in comparison were constructed from reviewing feedback from SBOs in the multiple case study, and identifying areas that required further exploration. The purpose of the interviews was to determine whether experts perceived that there were important concepts that SBOs should possess or whether there is a base level of knowledge that should be attained by SBOs in order to adequately manage the cash flow of their business.

### **B Participants**

Experts represented four groups, including academia, government, advocacy and advisory. Twenty-three experts participated in the project, with five experts representing the groups of academia, government and advocacy, and eight experts involved in advisory positions with small businesses.

The data for both the semi-structured interviews and the short survey was collected from experts during the same session, with the semi-structured interviews preceding the short survey questions. The duration of the sessions with experts ranged from 11 minutes to 40 minutes in length and all sessions were conducted over the telephone. Voice recording technology was used in order to capture the responses of participants and the data was transcribed at a later time. Telephone interviews were chosen to allow the researcher to engage experts from different States and Territories throughout Australia.

An overview of participant years of experience and roles held can be found in Table 1. Twenty participants had been involved in the small business landscape for more than five years. The remaining three participants were involved in assisting small businesses for a period of three to five years (two participants) or fewer than three years (one participant). Sixteen of the participants had been involved in more than one expert role over their years of experience, and six participants had previously owned a small business.

**Table 1: An overview of participant expertise in relation to small businesses**

<b>Expert</b>	<b>Years of experience</b>	<b>Field of expertise</b>	<b>Prior roles held as an expert</b>
ACA1	Over 10 years	Academic	No other role held
ACA2	Over 10 years	Academic	Accountant
ACA4	Over 10 years	Academic	Accountant
ACA5	5–10 years	Academic	Government/ATO employee

<sup>106</sup> Drexler, Fischer and Schoar, above n 16.



ACA6	Over 10 years	Academic	Government/ATO employee
ACC4	3-5 years	Accountant	No other role held
ACC5	Over 10 years	Small business advisor other than an accountant	Accountant
ACC6	Over 10 years	Small business advisor other than an accountant	Small business owner
ACC8	Over 10 years	Small business advocate	Small business advisor other than an accountant Government/ATO employee Small business owner
ACC10	Over 10 years	Accountant	Small business owner Board member of not-for-profit agencies
ACC11	<3 years	Small business advisor other than an accountant	Involved in advising ASBFEO on cash flow management practices
ACC12	5-10 years	Accountant	Small business advisor other than an accountant Small business advocate
ACC13	Over 10 years	Accountant	Small business advisor other than an accountant Government/ATO employee Small business advocate
ADV1	Over 10 years	Small business advisor other than an accountant	Small business owner
ADV3	5-10 years	Small business advocate	Government/ATO employee
ADV4	Over 10 years	Small business advocate	Government/ATO employee
ADV5	Over 10 years	Small business advocate	Accountant Small business advisor other than an accountant
ADV6	Over 10 years	Small business advocate	Academic Small business owner
GOV1	Over 10 years	Government/ATO employee	No other role held
GOV2	5-10 years	Government/ATO employee	Small business advisor other than an accountant
GOV6	Over 10 years	Government/ATO employee	Accountant Small business advisor other than an accountant

			Government/ATO employee Small business advocate Small business owner
GOV7	Over 10 years	Government/ATO employee	No other role held
GOV8	3–5 years	Government/ATO employee	Accountant

Key: ACA: Academic; ACC: Accountant or Advisor; ADV: Small Business Advocate; GOV: Government or ATO employee.

## V FINDINGS

Expert perception was explored to address two important questions for each of the areas of literacy addressed in this project. Expert feedback was sought on whether there are essential concepts or a base level of literacy that SBOs require in relation to use and understanding of financial statements, CAS and business taxation systems. The second question posed was whether the level of literacy that SBOs possess has an influence on their ability to manage cash flow in their business. The responses are discussed below under each literacy area.

### *A Professional financial literacy*

As previously mentioned, professional financial literacy includes having an understanding of financial statements, cash flow management, internal control mechanisms and corporate governance.<sup>107</sup> Two components of professional financial literacy are investigated in this project: (i) the understanding of financial statements; and (ii) the ability to implement cash flow management processes within a business situation. Determining the ability of SBOs to implement cash flow management concepts for this article was adopted from the definition of Drexler, Fischer and Schoar of effective cash flow management.<sup>108</sup> Effective cash flow management includes the activities of keeping financial accounts, maintaining a business plan and cash budget, keeping records of revenue and expenses, creditor and debtor invoicing and maintaining an inventory schedule.<sup>109</sup> Prior research suggests that SBOs are better equipped to operate their business if their literacy in these areas is adequate.<sup>110</sup>

#### *1 Expert perception of cash flow management processes implemented by small business owners*

Previous research suggests that effective cash flow management includes keeping financial accounts, maintaining a business plan and a cash budget, keeping records of revenue and expenses, creditor and debtor invoicing, and maintaining an inventory schedule.<sup>111</sup> The research explored opinions of expert participants and the importance

<sup>107</sup> Worthington, above n 5, 5.

<sup>108</sup> Drexler, Fischer and Schoar, above n 16, 13.

<sup>109</sup> Drexler, Fischer and Schoar, above n 16, 13; Ekanem, above n 8, 125.

<sup>110</sup> Berman Brown, Saunders and Beresford, above n 34, 179–80.

<sup>111</sup> Drexler, Fischer and Schoar, above n 16, 13; Ekanem, above n 8, 125.

they place on the concepts of effective cash flow management. The semi-structured interviews identified that understanding of cash flow and liquidity would be meaningful for SBO literacy. The largest number of responses related to liquidity and cash flow. Examples of participant responses are detailed below and highlight concerns that experts have in terms of SBO cash flow literacy:

Definitely you need to understand the principles behind identifying debtors, identifying aged payables, identifying what's profit, what's a loss, identifying those indicators of liquidity. Having that planning ahead of what's coming up in terms of your business debts and what your cash flow's going to be (ADV3).

I think they need to do some education around cash flow management because it doesn't come naturally to those that aren't financially inclined. Therefore, it is important, if not critical, for them to get their mind around numbers and cash flow versus profit in particular because there is a significant difference and a lot of owners just don't understand it (ACC13).

Probably the difference between what's profit and what is actual cash inflow and outflow. We find that a lot of small business owners don't understand the interaction between the profit and loss and the actual cash flow (ACC12).

To investigate cash flow management literacy further, experts were asked to indicate their thoughts in response to the survey statement: 'Small business owners have a good understanding of their cash flow.' Seven participants (30.44 per cent) agreed, five participants were neutral in their response and eleven participants (47.83 per cent) disagreed that SBOs have a good understanding of their cash flow (see Table 2). This indicates that nearly 50 per cent of experts have concerns about SBO understanding of cash flow, which is consistent with the prior literature.<sup>112</sup>

**Table 2: Expert survey responses relating to use of financial statements by SBOs (n=23)**

	<b>Strongly Disagree</b>	<b>Disagree</b>	<b>Neutral</b>	<b>Agree</b>	<b>Strongly Agree</b>	<b>Not Sure</b>	<b>Not Applicable</b>
a) Small business owners have a good understanding of their cash flow.	21.74	26.09	21.74	21.74	8.70	0	0
b) Small business owners have procedures in place to manage their cash flow.	13.04	43.48	26.09	13.04	4.35	0	0
c) Small business owners make use of financial statements to manage their cash flow.	17.39	52.17	21.74	8.7	0	0	0

<sup>112</sup> Belle Isle, Freudenberg and Copp, above n 9; Belle Isle and Freudenberg, above n 3.

d) Small business owners rely on the bank account to manage cash flow.	4.35	4.35	8.7	52.7	30.43	0	0
e) The cash flow statement should assist small business to manage their cash flow.	0	4.35	8.7	43.48	43.48	0	0
f) The Profit and Loss statement should assist small business to manage their cash flow.	4.35	26.09	13.04	21.74	30.43	4.35	0
g) The balance sheet should assist small business to manage their cash flow.	9.09	22.73	18.18	31.82	18.18	0	0
h) Small businesses should prepare a business plan to manage cash flow.	0	17.39	21.74	26.09	34.78	0	0
i) Small businesses should prepare a cash budget to manage cash.	0	0	8.7	30.43	60.78	0	0

Note: Results displayed as a percentage (%). Rounding may influence calculations as a per cent of 100.

In response to the survey statement ‘Small business owners have procedures in place to manage their cash flow’, the number of experts that disagreed increased from the prior question to three strongly disagreeing and ten disagreeing (see Table 2). Overall, this represents 56.52 per cent who believe that SBOs are not implementing procedures to manage cash flow. This would tend to suggest that experts have concerns as to whether SBOs are capable of managing their cash flow. The semi-structured interviews and survey questions then explored what concepts of effective cash flow management were considered important for small business success.

Relying on the definition of Drexler, Fischer and Schoar<sup>113</sup> to determine effective cash flow management, participants were asked to express whether they believed that SBOs should prepare a business plan to assist with management of cash flow. Fourteen participants (60.8 per cent) agreed in the short survey questions that a business plan should be prepared for managing cash flow (see Table 2), and only four participants disagreed (five were neutral). This suggests that experts consider a business plan to be a worthy instrument for effective cash flow management. However, the responses in the semi-structured interviews did not accentuate a business plan as being important to effective

<sup>113</sup> Drexler, Fischer and Schoar, above n 16.

cash flow management. None of the participating experts discussed a business plan when identifying necessary concepts that SBOs should maintain for management of cash flow. Consequently, the connection between a business plan and cash flow management is not clear. It may be the existence of a business plan itself will not assist cash flow unless it is regularly used and reused. Alternatively, experts may not consider that a business plan is as important as other cash flow management concepts and therefore did not discuss it in the interview. However, when prompted in the survey, they recognised it could be a worthy tool for managing cash flow.

There was a similar outcome when experts were asked to indicate whether they believed that preparation of a cash budget would assist SBOs to manage their cash flow. There was minimal discussion in the interviews about the usefulness of preparing a cash budget for cash flow management. However the short survey questions showed that 60.78 per cent strongly agreed (14 participants) and 30.43 per cent agreed (7 participants) that SBOs should prepare a cash budget in order to effectively manage cash (see Table 2**Table 3:**). The remaining two participants responded with a neutral answer. This demonstrates that, to some extent, experts believe that a cash budget is a worthy tool for effective cash flow management, but it is of concern that there was a lack of discussion of cash budgets in the interviews, especially when prior research suggests that absence of budgeting in small business is associated with business failure.<sup>114</sup>

The responses in the semi-structured interviews in relation to understanding of necessary concepts for professional financial literacy gave considerable support to SBOs having a thorough understanding of their debtors and creditors and what effect these concepts have on their cash flow. Collectively, there were 15 responses in the interviews relating to treatment of debtors and creditors (or aged payable or receivable). Predominantly this was discussed in concert with a misunderstanding of what these figures represent in the financial statements (this will be discussed further in the next section) and how credit transactions can give a false indication of the immediate cash flow situation of the business. That is because expenses may be purchased on credit, which does not immediately affect cash flow given that cash outflow is delayed.

The influence of credit vastly changes situations so that a person can go broke making a profit (ACA2).

Understanding of the concepts of debtor, creditors especially accounts payable and accounts receivable is probably another one that's really important (ACC8).

In terms of the requirement to keep financial accounts, including a record of revenue and expenses, minimal discussion (if any) was directed specifically at these concepts. However, the discussions in the interviews appeared to suggest that keeping these records are a necessary component of operating any business. This is particularly evident where experts believed there are specific financial statements that need to be maintained and understood. Without accurate and up-to-date records of transactions these financial statements would not be a true representation of the financial status of the business. That is, for records to be of any use to cash flow they need to be both accurate and up-to-date,

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<sup>114</sup> Fatoki, above n 1, 154.



because if records are accurate but old, or up-to-date but inaccurate, their usefulness is diminished.<sup>115</sup>

## 2 *Base level or concepts of financial statement literacy that should be acquired by small business owners*

In relation to financial statements, professional financial literacy includes reading and understanding balance sheets, income statements, statements of cash flow and preparing a cash budget.<sup>116</sup> Preparation and use of financial statements has been advocated as being effective in helping SBOs to make more informed decisions. Information from financial statements can illustrate the consequences of the business operations and the impact of previous financial decisions.<sup>117</sup> An important advantage of use of financial statements for small businesses is to provide up-to-date cash flow information. Regardless of the abundance of research that suggests that use of financial statements is valuable to the ongoing success of small businesses, it appears that SBOs in Australia and overseas make limited use of financial statements to assist them in managing their businesses.<sup>118</sup> This may be related to SBO financial statement literacy, as Fatoki<sup>119</sup> suggests that SBOs with higher levels of literacy produce and make use of financial statements more frequently than those with lower levels of literacy.

The survey response questions explored whether experts have witnessed SBOs making use of financial statements for cash flow management. Experts were first posed with the statement: 'Small business owners make use of financial statements to manage their cash flow' (see Table 2). Only two participants agreed with this statement. In comparison, 16 participants (69.56 per cent) disagreed/strongly disagreed (five participants gave a neutral response). This would suggest that experts do not think SBOs use financial statements to manage cash flow.

In comparison to the *use* of financial statements, the survey questions explored the reliance on the bank account balance. Experts were asked to give their thoughts on SBO use of the bank statement or bank account. In response to the statement: 'Small business owners rely on the bank account to manage their cash flow', 82.9 per cent of responses (19 participants) were in agreeance in comparison to 8.7 per cent disagreeing (Table 2). This suggests that experts believe that SBOs are relying heavily on their bank statement or bank balance as an indicator of cash flow.

In order to determine whether small business experts perceived that there are specific concepts of which SBOs should have understanding to have financial statement literacy, the semi-structured interviews addressed the question: 'In your opinion, what is the base level or concepts of literacy required by small business owners in relation to use and understanding of financial statements?' To facilitate discussion, participants were

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<sup>115</sup> Fatoki, above n 1, 154–5.

<sup>116</sup> Berman Brown, Saunders and Beresford, above n 34, 188.

<sup>117</sup> Bruhn and Zia, above n 43, 234 and 248; Fatoki, above n 1, 153.

<sup>118</sup> DeThomas and Fredenberger, above n 12; Dyt and Halabi, above n 47; Halabi, Barrett and Dyt, above n 25; Peel, Wilson and Howorth, above n 11; Sharma and Iselin, above n 48.

<sup>119</sup> Fatoki, above n 1, 153.

supplied with a list of possible concepts that might be considered when determining financial statement literacy (see Appendix 1).

As already discussed in the prior section, there was a large number of responses that related to aged payables and receivables and liquidity and cash flow. However, in terms of financial statement literacy, there were varying views on which concepts and financial statements were necessary for a SBO to be considered literate. Only one participant mentioned the need to understand accounting ratios. This suggests that accounting ratios may not be considered a necessary part of professional financial literacy for SBOs.

An attempt was made to determine whether experts believed that certain financial statements were better suited or gave more value to a SBO for cash flow management. The semi-structured interviews and the survey questions explored the importance experts placed on use of financial statements for cash flow management. The interviews gave varying feedback regarding the necessity to understand financial statements:

I think the base level concept is around, the difference between assets and liabilities. How much equity they have; fundamentally the difference between a balance sheet and a profit and loss statement, and what they can be used for. I suppose it's probably more about what financial statements can be used for in terms of running their business (ACA6).

The expert feedback in the interviews relating to the importance of specific financial statements was diverse. The largest number of responses in the interviews related to the profit and loss statement, followed by the balance sheet and the statement of cash flow receiving equal feedback. The outcome of the survey questions, however, placed the statement of cash flow as the most important financial statement to assist with management of cash flow. Feedback from the survey questions relating to the profit and loss statement suggested that just over half (52.17 per cent) of the expert participants believe it to be useful for cash flow management. Thirty per cent disagree that it is a cash flow management tool and the remaining experts were either unsure or gave a neutral response about its purpose for cash flow management (Table 2). The interview responses however were more supportive of the profit and loss statement. Participants gave the following feedback:

Well I think they need to understand where they're making a profit, so profit and loss, and they need to determine short and long term viability (ACA5).

So probably the base level of using financial statements should be the ability to read the profit and loss, and in terms of understanding, the big thing we try and get people to focus on is their gross profit margin (ACC10).

For a business starting out they should understand financial statements and difference between revenue and profit and loss (ACC12).

The balance sheet was determined the least useful statement to assist with management of cash flow in the survey questions (Table 2). Fifty per cent of participants agreed/strongly agreed that it was effective, whereas 31.82 per cent disagreed and 18.18 per cent gave a neutral response. These results are supported by the lack of responses on balance sheets from the interviews. Only two experts gave feedback about the necessity for SBOs to understand the balance sheet in order to have professional financial literacy. Those comments did not provide persuasive arguments to conclude that understanding of the balance sheet is important for professional financial literacy.

The survey questions expressed significant support for the understanding of the statement of cash flow as a tool for cash flow management (Table 2). Participants were asked to respond to the statement: 'The statement of cash flow should assist small business to manage their cash flow.' An overwhelming response of 87 per cent of participants (20 people) agreed that this is a useful statement for cash flow management. Only one participant disagreed and the remaining two experts gave a neutral response. As mentioned, the interview comments were not as supportive of the statement of cash flow as a necessary component of professional financial literacy. Comments relating to the statement of cash flow were:

So obviously the statement of cash flows would be probably the most important; and the profit and loss; and the balance sheet, I guess would be the next (ACA2).

We try and encourage clients to do annual forecasting but probably get them more to focus on a 12 week cash flow forecast, which is more probably dynamic and continuing. So in terms of using financial statements, the cash flow statement is the most important (ACC10).

Although understanding and use of the statement of cash flow was not well discussed in the interviews, cash inflow and outflow and the distinction between cash and profit was given substantial consideration overall in terms of cash flow literacy (see previous comments). This suggests that knowledge and understanding of liquidity is an essential part of professional financial literacy.

In summary, experts suggest that SBOs do not currently make use of or understand their financial statements. The results demonstrate that experts have observed that SBOs place more significance on the information obtained from the bank account as an indicator of cash flow stability than any other source. This is concerning, considering that unlike the statement of cash flows the bank account balance does not take liabilities into consideration.

In contrast, small business experts propose that the most influential financial statements that SBOs should make use of and understand in order to be literate include the statement of cash flow and the profit and loss statement. Preparing a cash budget and a business plan were also given strong support by experts as necessary components for cash flow management and professional financial literacy. Financial concepts that have been implied by experts as being essential for SBOs include identifying indicators of liquidity or recognising cash flow issues, such as understanding the effect of aged payables and receivables on cash flow, determining the difference between profit and cash, and having some ability to prepare and maintain a cash budget or forecast.

### *3 Does the level of small business owner professional financial literacy influence their ability to manage cash flow?*

The views of experts were examined in relation to whether the level of professional financial literacy of SBOs has any impact on their ability to manage cash flow.<sup>120</sup> Only one participant suggested that literacy levels have no bearing on cash flow management from

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<sup>120</sup> Berman Brown, Saunders and Beresford, above n 34, 179–80.

a financial statement literacy perspective, and this was because financial statements only provide SBOs with historical data and are of no use for cash flow management:

Most of them don't understand their financial statements and I don't think that influences their ability to manage cash flow. Basically, nobody uses financial statements produced by their accountant, you're onto the next financial year before you get them (ACC6).

However, this statement appears to be more in terms of end-of-year reporting including balance sheets and profit and loss statements. This participant argues that end-of-year reporting is redundant for cash flow management due to the statements by that time containing historical data. This suggests that the level of SBO literacy is irrelevant because these financial statements do not have currency to be useful for cash flow management.

The remaining feedback from experts all confirmed that the level of literacy has some impact on management of cash flow. The responses from participants revolved around four main themes. Experts suggested that literacy levels influence the SBO's ability to succeed by allowing them to understand the principles in the financial statements, to identify cash flow issues in advance, to illustrate the effects of previous decisions, and to have more informed conversations with external stakeholders. The expert feedback reinforces the existing literature suggesting that adequate professional financial literacy supports SBOs with everyday functions in the workplace and allows them to make more informed and strategic decisions.<sup>121</sup>

First, responses indicate that without adequate literacy SBOs are not equipped to interpret the important information contained in the financial statements in terms of cash flow. Misunderstanding of the concepts and principles required to read financial statements can leave SBOs in a vulnerable situation in terms of their cash flow.<sup>122</sup> Experts expressed their concerns about inadequate ability to understand these concepts in the financial statements:

A lot of small businesses don't succeed because they don't understand the financial statements. If they don't create them or don't understand them, then that causes cash flow problems. So yes, a very strong relationship between the literacy and managing cash flow (ACA5).

The level of literacy that they hold in many ways can influence the success of the business because they need to understand how to manage their revenues and their expenses. They can pay an accountant to do that but it's expensive and they tend to shy away from that and they tend to do it themselves. Therefore, especially in those initial stages of owning a business, the higher their level of literacy around financial numbers the greater the chances of them succeeding in managing their business (ACC13).

Similar to research by Bruhn and Zia<sup>123</sup> and Fatoki,<sup>124</sup> experts expressed their views on how increased literacy of financial statements can improve the SBO's cash flow effectiveness, and their firm's performance and growth. It was stated that being more

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<sup>121</sup> Ibid.

<sup>122</sup> Fatoki, above n 1, 156.

<sup>123</sup> Bruhn and Zia, above n 43, 234 and 238.

<sup>124</sup> Fatoki, above n 1, 179–80.

literate allows SBOs to be more informed in discussions with external stakeholders and reduces expenditure when engaging advisors:

A higher level of literacy also helps them to contain advisor costs because it means that they have the capability to put together briefs and statements and information in a way in which it saves advisors time in terms of getting on top of and understanding what their business is (ACC13).

Having adequate professional financial literacy has been advocated as being influential in helping SBOs to make more informed decisions, which in turn facilitates improved performance.<sup>125</sup> Expert responses support prior research, by implying that increased literacy in financial statements assists SBOs in identifying the consequences of previous financial decisions on business operations:

The higher the level of literacy, the better the understanding of financial statements. They can then see and recognise the early warnings including any variances and react and respond to make it favourable to them. If their literacy is low, then their understanding of it is low and therefore they may not even be able to read the signals even if they do get the information (ADV1).

Previous research indicates that cash flow understanding is critical in determining solvency and therefore limitations in literacy are likely to cause detrimental effects to ongoing business viability.<sup>126</sup> Higher levels of cash flow and profitability literacy has been advocated to allow SBOs to make a more accurate assessment of the present status of their business and assist with implementing strategies to overcome any cash flow problems.<sup>127</sup> Some experts expressed their concerns about SBOs misunderstanding profitability and cash flow, and the implications that can result from a lack of knowledge of these concepts:

It does influence their ability to manage their cash flow because if they don't understand how the cash that they spend impacts on their finances then they can have cash issues. We find that a lot of people say that they don't make a profit because they've got no money, which is not necessarily true. They just spend all of the money, they just don't realise how it's been flowing through the financial statements (ACC12).

Overall it appears that the majority of experts in the research perceive that the level of a SBO's literacy has an impact on their ability to manage their business cash flow. Concerns were expressed about limitations in professional financial literacy having a negative impact on the ability of SBOs to identify early warning signs of cash flow issues. Experts suggested that in order to support cash flow, SBOs should have a level of literacy that allows them to compare current financials with prior figures, determine the consequences of previous decisions in order to be more informed about decisions in the future, and have increased awareness of financial status in order to have more educated conversations with advisors and external parties.

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<sup>125</sup> Bruhn and Zia, above n 43, 234 and 238.

<sup>126</sup> Sharma and Iselin, above n 48.

<sup>127</sup> Ibid.



### **B Computer accounting software literacy**

Recent research by Belle Isle and Freudenberg<sup>128</sup> indicates that the CAS is not being used effectively to assist with management of cash flow, as there is low engagement in the use of CAS reporting options. Considering that CAS literacy is a relatively new concept, this project relies on two areas of professional financial literacy, cash flow management and understanding of financial statements, to determine CAS literacy. The research investigates the use of CAS for cash flow management activities including preparing a cash budget, keeping records of revenue and expenses, creditor and debtor invoicing and generation and use of financial reports.

#### **1 Base level or concepts of CAS literacy that should be acquired by small business owners**

Experts were asked to determine if there are specific functions in CAS that SBOs should be capable of performing. First, the survey questions explored whether experts have observed that record keeping is accurate as a result of the use of CAS by SBOs. As illustrated in Table 3, 12 participants (52.18 per cent) agreed that small business records are more accurate as a result of CAS, in comparison to 17.39 per cent who disagreed and 30.43 per cent who gave a neutral response.

**Table 3: Expert survey responses relating to use of CAS for cash flow management**

	<b>Strongly Disagree</b>	<b>Disagree</b>	<b>Neutral</b>	<b>Agree</b>	<b>Strongly Agree</b>	<b>Not Sure</b>	<b>Not Applicable</b>
a) Small businesses have reliable records as a result of their CAS.	4.35	13.04	30.43	47.83	4.35	0	0
b) The initial setup of CAS should be carried out by an accountant or adviser.	0	4.35	13.04	34.78	47.38	0	0

The large number of neutral responses might be explained by the responses given in the semi-structured interviews, where experts were asked to respond to the question: 'In your opinion, what is the base level or concepts in terms of operating CAS that is required by SBOs for cash flow management?' Participants were provided with a list of possible CAS concepts that they could refer to in order to determine CAS literacy requirements (see Appendix 1). One theme that presented a number of times related to the incorrect coding of transactions and how that could result in inaccurate processing of records. This concern can be seen in the following comments:

<sup>128</sup> Belle Isle and Freudenberg, above n 3.

As we all know, data output is only as good as the data in. If the data's been classified or incorrect, then it's not that useful to them. They have to have a base understanding of how to code the transactions themselves so that they can generate the output that they need (GOV1).

Half the time I think they're struggling because of errors that come up in the accounting software from incorrect entering of data (ADV3).

This argument is strengthened by the feedback given in the survey statement: 'The initial setup of CAS should be carried out by the accountant or advisor' (see Table 3). Nineteen of the twenty-three participant experts (82.61 per cent) agreed that the CAS initial setup should be the role of the accountant or advisor. This indicates that experts perceive that there may be a relationship between coding errors and incorrect setup of the software. Participant GOV1 discussed the requirement to have the initial setup carried out by an expert if the SBO's literacy is lacking in that area:

I think it depends on the software. I don't know that the business owner necessarily has to understand how it all works if they can set it up properly or they can get someone to set it up properly for them (GOV1).

The purpose of the semi-structured interviews was to determine what concepts and functions of the CAS the SBO should be able to complete in order to be considered CAS literate. The responses from the participants were varied. Some participants believed that CAS was not useful for cash flow management and could be detrimental to educating and increasing knowledge of accounting concepts for SBOs. One participant believed that CAS removes the requirement for SBOs to undertake basic accounting, which prevents them from undertaking fundamental accounting procedures on a regular basis:

The reliance on electronic data processing has overcome good basic sound accounting knowledge – everybody now is an expert because they can hit a key on the computer (ACA2).

This response contradicts prior research that suggests use of software and information systems increases financial awareness, efficiency and performance of small businesses.<sup>129</sup>

Two of the participants suggested that SBOs should have a minimum level of literacy that allows them to produce and understand financial reports available in their CAS:

Definitely they do need to know which reports to print, how often to print them. So you want to keep your eye out on your cash flow regularly; profit and loss statement, you want to do at least monthly; and balance sheet that can be done on a less frequent basis (GOV6).

They should be using it as a management tool. I try to get my clients to do a monthly profit and loss, and aging debtors and aging creditors, because then you can see how their cash flow is going (ACC11).

The remaining experts believe that a thorough understanding of how CAS functions is necessary to be considered as having adequate CAS literacy. Participant GOV7 gave a detailed description of what SBOs should be capable of when operating their CAS:

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<sup>129</sup> Fatoki, above n 1, 156; Hunt and Iyer, above n 70.

Ideally, they should be able to produce reports and understand what those reports are telling them. So they need basic digital literacy, then they need to understand their actual accounting software, what it will do and what it won't do for them. They need to know how to use it, and they need to know how to get value out of it relevant to running their business effectively. They don't need to be experts but they do need to have a level of ability to use the software to actually help them run the business (GOV7).

Overall, 19 of the 23 experts believed that CAS literacy of SBOs should at a minimum allow them to produce and understand financial reports. Three experts extended their ideas of the minimum level of literacy to suggest that a thorough understanding of how CAS functions is necessary in order to be considered CAS literate. In contrast, experts concur that the initial setup of a CAS system does not form part of SBO CAS literacy, and instead experts believe that the setup should be carried out by an accountant or advisor. This was seen as a necessary practice to prevent incorrect recording and coding of transactions in the future.

## *2 Does the level of SBO CAS literacy influence their ability to manage cash flow?*

The semi-structured interviews explored whether experts believed that SBOs, CAS literacy influenced their ability to manage their cash flow. Three participants agreed that CAS literacy levels were important for cash flow management. Their responses suggest that without CAS knowledge the reports and data available will be worthless and serve little purpose for cash flow management:

Looking at your financial statements and having good accounting software and knowledge helps to analyse cash flow. It helps you to look forward, thinking about your tax liabilities and other debts and planning for those (ACC8).

The remaining comments from experts revolved around SBOs' knowledge of accounting concepts. It appears from the data analysis that participants perceive that management of cash flow using CAS is reliant on SBOs' understanding of basic accounting concepts:

It's not literacy of the computer accounting software, it's literacy of debits and credits or what's profit and loss, that influences their ability to manage cash flow when using their software (ACC12).

A review of the data suggests that it is not solely the level of understanding of the functions in CAS that influences SBOs' ability to manage cash flow. It appears that knowledge and understanding of basic accounting concepts complements or underlies SBOs' CAS literacy levels. This is concerning when taking into account the views of participant ACA2, who suggested that reliance on electronic data systems for recording of business transactions has eroded basic financial and accounting knowledge of SBOs. This is a result of SBOs never having to determine the treatment of the transactions that they process through the CAS system.

## ***C Business taxation literacy***

SBOs have been identified as being broadly tax literate in relation to individual tax systems, however this level of literacy may not be sufficient for business tax systems. Prior research suggests that the level of tax knowledge of SBOs is not sufficient for management

of their ongoing business tax obligations.<sup>130</sup> This research explores the perception of experts in regard to the level of business tax literacy required by SBOs in order to manage cash flow and in turn a successful business.

#### 1 *Base level or concepts of business tax literacy that should be acquired by small business owners*

Prior literature suggests that a managerial benefit is available for businesses from recording transactions for tax compliance.<sup>131</sup> This is attributed to the regularity of recording accounting transactions in order to satisfy tax reporting obligations. The survey questions were utilised to determine whether experts believed that record keeping for taxation purposes assisted SBOs in managing their cash flow, allowing them to recognise this benefit. Seventeen of the experts agreed/strongly agreed that tax recording is beneficial for cash flow management. Only two participants disagreed/strongly disagreed. Responses are displayed in Table 4. This would suggest that tax obligations are perceived as being beneficial to SBO cash flow management.

**Table 4: Expert survey responses relating to business tax systems and cash flow of small business**

	<b>Strongly Disagree</b>	<b>Disagree</b>	<b>Neutral</b>	<b>Agree</b>	<b>Strongly Agree</b>	<b>Not Sure</b>	<b>Not Applicable</b>
a) The records and information generated by tax obligations assist small businesses with managing their cash flow.	4.35	4.35	13.04	47.83	26.09	0	4.35

The semi-structured interviews then explored the level of business tax literacy required for SBOs. Participants were asked: 'In your opinion, what is the base level of literacy or concepts of business taxation required by SBOs to be considered literate?' There were two common themes that emerged. The most prevalent responses were focused on being aware of their obligations and realising that the tax liability is a business expense. Research by McKerchar<sup>132</sup> showed that determining correct payment and lodgement dates for taxation was a complex issue for SBOs. Experts today appear to suggest that awareness of lodgement and payment dates are still necessary components of business tax literacy:

They definitely need to have a good understanding of when those payments need to be made so they can manage their cash flow appropriately (ACC11).

<sup>130</sup> Freudenberg et al, above n 4; McKerchar, above n 77.

<sup>131</sup> Lignier and Evans, above n 56.

<sup>132</sup> McKerchar, above n 77, 34.

They should know how often they have to report in their tax returns and they should know what dates they have to pay the tax. They should know the dates that they have to fill in those reports and should be able to communicate with their advisers (ACA5).

Participants were also concerned that SBOs did not plan for the payment of the tax liability. This could be a result of SBOs not recognising that tax is a business expense or not being able to predict or forecast the amount of tax that will be due at the end of each reporting period. This can result in the tax liability owing to the ATO being classified as cash available for business spending.

A number of participants gave feedback about specific tax systems and necessary concepts in those tax systems of which SBOs should be aware. The most frequently discussed tax system was GST. The feedback from experts related to rules about taxable supplies and credits, understanding what goods are subject to GST, and determining if your business is required to be registered:

With GST, which goods or services have GST and which ones don't and how that affects cash flow. I think GST is more about cash flow (ACA 6).

GST on a base level, I think people understand there are taxable [supplies], and there are credits coming back. I think they need to have a base understanding of those concepts, and then how that fits into preparing a BAS (ACC10).

Minimal feedback was given in relation to literacy required for the other business tax systems relevant to this research. Experts made comments regarding income tax, PAYG instalments and fringe benefit tax – however, the feedback was scarce. Responses for income tax concentrated on understanding depreciation and determining the deductions available to the individual business:

My view is that there are basic concepts around what's deductible and what's not. What's a deduction and what's depreciation (ACA6).

Income tax is a bit different. Income tax, because of the way that it operates, you probably have to have less knowledge of it, but it is always good to understand what concessions are available to you so that you can make the best use of those that are available (GOV1).

One expert discussed the importance of SBO literacy for PAYG instalments,<sup>133</sup> particularly in the first year of trading. This participant suggested that without the required level of business tax literacy, SBOs could experience significant cash flow problems if they have not forecasted or set aside funds to satisfy their income tax liability for the first year. Subsequent years will incur a PAYG instalment that is required to be paid throughout the year based on the previous year's income.<sup>134</sup> However, considering that there is no prior trading in the first year, the income tax liability will be due as a lump sum once the return is lodged with the ATO:

Pay as you go instalments will, as a matter of course, be a negative to your cash flow because of what it does. Essentially, it's a provision towards your income tax liability for that particular year, so you're actually paying it earlier than you otherwise should have.

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<sup>133</sup> *A New Tax System (Pay As You Go) Act 1999* (Cth).

<sup>134</sup> *Ibid* pt 2-10 sub-div 45-C.

Particularly for small businesses that are starting out, they can get themselves into quite a bit of trouble because they haven't actually been making provision for their income tax liability throughout the year, so when they lodge that first return that has a tax liability on it, there's nothing to offset that liability, with a lump sum amount that they have to then find the cash for. Unless they've actually been putting the money aside – we call it pay as you go instalment lag or pay as you go instalment shock because the return comes in, it's probably nine months after the end of the relevant income year, they're going okay (GOV1).

This feedback differs to the results of the research in 1995 relating to provisional tax. McKerchar<sup>135</sup> suggested that SBOs experienced complexity with the understanding that a provisional tax payment decreased the overall amount of tax liability owed at the end of the reporting period. Current expert feedback in comparison suggests that the most significant issue for cash flow is not identifying the implications of not paying an instalment in the first year of trade, and the possible restrictions to cash that SBOs could face when the tax liability is due in the subsequent year. This supports the responses in a recent related case study project of small business participants,<sup>136</sup> where business owners suggested that more education is required at the start-up of a business in relation to the likely tax liability that will be owed at the end of the first year of trade.

Expert ACC5 supported research by McKerchar,<sup>137</sup> suggesting that fringe benefit tax literacy needs to be improved. Lack of understanding by SBOs about what is classified as a fringe benefit is still prevalent in today's small business environment:

A lot of small businesses don't pay FBT. But they should. A lot of them have got exposures and they don't even know they've got an exposure (ACC5).

In summary, expert feedback indicates that record keeping for tax obligations is still regarded as being beneficial for cash flow management. Concepts identified as being essential for SBO literacy with respect to business tax systems include the need to be aware of ongoing tax obligations, and determining the correct lodgement and payment dates for the tax systems that are relevant to their business. SBOs should also be capable of identifying that tax liabilities are a business expense and should be able to differentiate between the money allocated to tax liabilities and cash available for business trade.

In regard to specific tax systems, the largest number of participants identified GST concepts as being necessary for SBO tax literacy. In particular, concepts highlighted as critical were rules relating to taxable supplies and credits, determination of goods subject to GST and understanding the GST registration requirements and thresholds. Other tax concepts that are considered crucial for SBO literacy include determination of what is considered a fringe benefit, identifying available deductions and concessions, understanding depreciation, and forecasting for income tax liability in the first year of trade before PAYG instalments become part of business tax obligations.

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<sup>135</sup> McKerchar, above n 77.

<sup>136</sup> Belle Isle, Freudenberg and Sarker, above n 64.

<sup>137</sup> McKerchar, above n 77.



2 *Does the level of SBO business tax literacy influence their ability to manage cash flow?*

The collection of data then focused on the perception of experts about the effect of SBOs' business tax literacy on cash flow management. One expert expressed their concerns about SBOs' ability to manage cash flow. However, they suggested that the relationship between business tax literacy and cash flow management is irrelevant. They implied that SBOs should have simple understanding of tax where calculation of the tax liability as part of cash flow should be predicted as one-third of net profit:

I see cash flow management as a vastly superior problem to taxation. If a small business is making a good profit, tax is an irrelevance. Quite simply, all the business proprietor has to understand is that it's roughly a third of his net profit: that's his depreciation costs (ACA2).

In comparison the remaining participants suggested that the level of SBOs' business tax literacy would likely influence their ability to manage cash flow. One participant suggested that taxation was more complicated for SBOs than any of the other requirements of running a business, and therefore their business tax literacy would have some bearing on their ability to manage cash flow:

I think it probably is more in relation to the taxation, the GST, PAYG withholding and super guarantee side of things. Because the tax obligations, I think, do have an impact on their ability to manage cash flow. My view is that they probably have less literacy in relation to the taxation obligation, than they do in relation to their general business (ACA6).

Two participants highlighted the importance of business tax literacy and its relationship with cash management, particularly in relation to forecasting for the tax liability:

They absolutely need to understand taxation obligations because in my view it impacts cash flow directly. You have to have the cash flow to pay the tax when due (GOV2).

I mean just the basic issue of GST, to be able to account for that and budget for that, so that when it does become due, that it is there and can be paid on time without them spending it and having it included in their day to day cash. They think their cash flow is good but it's not because part of it is their tax liabilities (ADV1).

The remaining feedback proposed that the impact of business tax literacy on cash flow management revolved around the level of literacy held in financial statements and CAS. Experts indicated that insufficient literacy in the other two areas would have negative consequences on the level of business tax literacy held, and in turn the ability to manage cash flow. This suggests that in order to have business tax literacy SBOs need to be literate in financial statements and CAS. These outcomes broadly contradict the proposition by Chardon et al that a base level of literacy in taxation and superannuation is required in order to be financially literate.<sup>138</sup> Alternatively, the results may not oppose Chardon et al, but may suggest that taxation, superannuation, financial statement and CAS literacy work in concert with each other, and having a high level of literacy in any of these areas is in

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<sup>138</sup> Chardon, Freudenberg and Brimble, above n 4.

turn beneficial to an individual's understanding of other concepts, especially their ability to manage cash flow.<sup>139</sup> Comments of experts are highlighted below:

Literacy has consequences on their cash flow. So, if they're not fully understanding tax, financial statements and computer accounting software then it will influence negatively if they're not sure how these interplay with their cash flow. If you don't know what the tax consequences are then you're not going to be able to project the cash correctly (ACC5).

What I would say is that there is a proportion, well less than half, of small businesses who start out with the required literacy and capability to actually effectively manage their finances, their business planning, and their tax and superannuation. Therefore, the remaining small business owners can't manage their cash flow because they don't have those capabilities. They simply can't do it. They don't understand basic things like the difference between their business income and their personal income. Business expenses, personal expenses. Their level of understanding is very low. Consequently, they get into financial strife or under financial stress very quickly (GOV7).

In summary, analysis of the data from the semi-structured interviews indicates that the level of business tax literacy held by SBOs could have some influence on their ability to perform effective cash flow management. Participant responses indicate that experts are mostly concerned that SBOs lack the capacity to determine the remaining cash available after taking the tax liability into consideration. Responses from the remaining six experts who discussed the influence of business tax literacy on cash flow management indicates that the level of SBO business tax literacy may have a relationship with their literacy in the other areas investigated in this research. Experts perceived that business tax literacy of SBOs is supported by their level of financial statement and CAS literacy when taking cash flow management into consideration.

## VI CONCLUSION

This article detailed the findings of a study that sought to explore the critical issue of cash flow for small businesses. In particular, the article reported what business experts thought about SBO professional financial, CAS and business tax literacy and how these literacies may or may not influence cash flow management.

Overall, it appears that in order to have professional financial literacy, experts believe that SBOs should make use of a cash budget, business plan, profit and loss statement and cash flow statement. However, a critical part of using these documents in the management of cash flow is the ability to extract meaningful information in order to understand their cash flow situation. Essential information includes how to interpret the difference between cash and profit, and the effect of cash receipts in comparison to aged receivables and payables.

For CAS literacy, SBOs should ideally have a thorough understanding of how CAS functions, and at minimum be capable of producing financial reports and comprehending the information contained in those reports. With regard to the effect of CAS literacy on

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<sup>139</sup> Ibid.

management of cash flow, experts consider comprehension of basic accounting concepts as a requisite to CAS literacy concepts.

When assessing business taxation literacy, experts suggest that SBOs should be aware of their ongoing tax obligations and determination of correct lodgement and payment dates for the tax systems that are relevant to their business. In regard to specific tax systems, identification of goods attracting GST and rules relating to registration, thresholds, taxable supplies and credits were considered essential for GST literacy. For income tax, necessary concepts highlighted were identification of allowable deductions and concessions, comprehension of depreciation rules and understanding the impact of the tax liability on cash flow after the first year of business trade.

Experts expressed concerns that SBO business tax literacy could impact cash flow management if SBOs were incapable of differentiating between the money allocated to tax liabilities and cash available for business trade. Experts propose that to effectively manage cash flow, SBO taxation literacy needs the support of adequate levels of professional financial literacy and CAS literacy.

## VII RECOMMENDATIONS, LIMITATIONS AND FUTURE RESEARCH

If experts perceive that cash flow management in small businesses is related to the interaction of SBO literacy in terms of business taxation, CAS and professional financial literacy, then mechanisms should be adopted that seek to bring their literacy to an adequate level. Although there are mixed reviews in past research about the effectiveness of literacy education, there are a number of ways that education initiatives have been considered successful in other countries for SBO.<sup>140</sup>

Tailoring advice to the individual user can be effective if delivered through the process of either just-in-time education or one-on-one coaching. Just-in-time education or one-on-one coaching allows advisors to satisfy the diverse characteristics of the individual SBO and provide education at a time that is relevant to the current situation of each individual small business.<sup>141</sup> In order for the SBO to recognise any benefit from training the content should be delivered in descriptive language that is clear and straightforward.

The introduction of tax preparation software similar to systems used in the United States of America and Austria could also be useful, as these systems provide financial advice and indicators to users, which in effect improves their financial awareness.<sup>142</sup>

One way of achieving or directing SBOs to undertake training could be through the ATO. As an alternative to imposing a shortfall interest charge on an amended assessment or a penalty for making a false or misleading statement, the Commissioner could, at their discretion, impose a training order on the SBO. This training order could be related to improving the literacy of the SBO and be required to be undertaken within a specific period of time. The order could also determine the duration that the SBO should be

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<sup>140</sup> Daniel Fernandes, John G Lynch and Richard G Netemeyer, 'Financial Literacy, Financial Education, and Downstream Financial Behaviors' (2014) 60(8) *Management Science* 1861, 1875.

<sup>141</sup> Fatoki, above n 1; Eleonora Johanna Kuiper and Marijn Janssen, 'Re-Using Taxpayer's Data: Scenarios for Wealth Management for the Public' (2018) 4(1) *Journal of Tax Administration* 88; Stone, above n 59.

<sup>142</sup> Hunt and Iyer, above n 70; Kuiper and Janssen, above n 141.

involved in the training. The costs related to engaging in training under a training order imposed by the Commissioner would not be eligible as a tax deduction for the small business, as it should still be treated or related to fines and penalties under s 26-5 of the *Income Tax Assessment Act 1997*.

It is acknowledged that this article does not look in depth at individual demographics and characteristics of SBOs that could restrict the level of literacy that is achievable. The purpose of the article was to examine expert perception of what level of literacy is desirable to all SBOs. A limitation of the article is that it only reports one part of a larger research project and although there is considerable content discussed in terms of expert views on literacy, it is impracticable to review in depth the other stages of the project that have already been completed. A further constraint of the findings in this article is the small number of participating experts. Although it should be acknowledged that the intention of the research was to explore the findings from a multiple case study of SBOs that was carried out prior to this part of the research and to examine perception of a range of small business experts into what was considered the necessary level of literacy to support cash flow management.

Given the findings of this study, there are a number of relationships that could be explored in the future. Considering that there is conjecture regarding the usefulness of literacy training for SBO, it would be beneficial to explore on a larger scale the views of SBO into different forms of literacy education or to conduct experiments with SBO to determine what would be the best delivery option for retention of concepts required for literacy in support cash flow management. Particularly the use of tax preparation software used in other countries could be trialed throughout the small business sector. The research has also highlighted important concepts relating to professional financial literacy, CAS literacy and business tax literacy. Future studies could investigate on a larger scale SBO confidence, perceived importance, actual literacy and perceived literacy in relation to the concepts identified by small business experts.

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### **B Legislation**

- A New Tax System (Pay As You Go) Act 1999* (Cth)
- Income Tax Assessment Act 1997*

## APPENDIX 1

Base level literacy could include some or all of the following concepts.

<b>Financial statements</b>	<b>Computer accounting software (CAS)</b>	<b>Small business taxation</b>
Understand liquidity ratio	Perform original setup of accounts in CAS	Understand reporting and payment dates for taxes
Understand indicators of insolvency	Input data for creditor and debtor invoicing	Prepare income tax returns, business activity statements, instalment activity statements, superannuation reports
Determine profitability in income statement	Maintain bank reconciliation in CAS	Understand superannuation guarantee and superannuation contribution
Understand net value in balance sheet	Perform setup of employees, including tax and superannuation obligations	Understand fringe benefit determination
Understand the difference and effect of current and long-term debt	Prepare superannuation reporting and payment	Understand treatment of dividends, dividend imputation credit, factoring accounts
Analyse comparative data in: cash, accounts payable/receivable, equity, inventory and retained earnings	Prepare IAS and BAS in CAS	Understand: income; business income; revenue vs capital receipt; immediate deduction; small business capital gains tax; repairs; depreciation; small business immediate deductions; marginal tax rates; Medicare levy
Understand the difference between operational costs, asset investments and finance in the cash flow statement	Determine tax treatment of transactions in CAS	Effectively communicate with financial and tax advisers
Compare the income statement and cash flow statement to determine if there are non-essential expenses	Produce financial reports from CAS including balance sheet, income statement, statement of cash flow	Understand GST terminology: GST free; non-reportable; GST inclusive/exclusive; taxable supplies; input tax credits
Understand the concepts of debtors, creditors, assets, liabilities and equity	Prepare a financial budget in CAS	Understand capital gains tax, 50 per cent CGT discount, small business CGT concessions
Make use of information in financial statements to support preparation of a business plan or budget	Moderate level of proficiency in business-related software, including Excel	Understand treatment of offsets, deductions, write-offs, concessions, tax rates

Source: The concepts listed in this table have been collated from a variety of sources including: articles referred to in the literature review of this article; the findings of the multiple case study of SBOs that preceded the data collected for this article; and the researcher's own ideas.